Master’s Degree Programme in Business Administration

Integrated Reporting Process: Its Relevant Issues

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Introduction

In the twenty years, the global economies have faced with several issues, scandals and at the extreme point, crisis. In such a context, all the weaknesses and lacks of the systems, which have tried to regulate and support the same economies, came to light as well as the need for changes. In this chaotic and uncertain environment, the society has arisen its requirements in order to avoid, or at least to limit, other economic uncertainties. The new requirements were demanded to those parties, which both in the past and in the present run the economies: the organizations of all types. The companies have been asked to be accountable for their actions, to respond for their activities, to provide the market with trustable and complete data, to be transparent with respect to all their stakeholders. At this stage, the need for an effective and exhaustive information disclosure has become the trait d’union between the society’s requests and the companies’ duties.

In this scenario during the last decade, new methodologies related to corporate reporting activities have been developed as a response to the new societal needs. These new forms of information disclosure have diversified themselves from the most traditional forms of corporate reporting: the financial information disclosure. The necessity of being responsible for all the activities performed, push the companies in disclosing not only financial results but also non-financial commitments. In this context, some academics and some international bodies interested in the reporting activities have promoted a new practice: the Integrated Reporting process.

The following work has been articulated in four main chapters: the first one contains the detailed description of the milestones at the basis of the Integrated Report and a brief excursus of which have been the main antecedents of the new reporting process as well as the reasons behind the necessity to introduce this new type of corporate reporting. The IR’s fundamentals are constituted by the Content Elements, the Guiding Principles and the six Capitals’ explanation, taking as a reference point the guidance provided by the most important international organization in this field: the International Integrated Reporting Council. The aim of the first chapter is simply to provide the reader with a complete overview of this new reporting area, emphasizing how the non-financial features differ from the traditional forms of financial reporting, which remains the only mandatory requirement for which the organizations have to be accountable for.
In the other three chapters the focus has been shifted on the Integrated Reporting’s main critiques: the materiality of information, the connectivity of data and the assurance of non-financial performance. The second chapter concerns the materiality and how the companies should try to achieve it in order to disclose information in the most effective way. Different models of how materiality could be reached are presented, in order to provide the companies with several methodologies aiming at the same objectives. However, even if the methods are described in detail by different international bodies involved in this development, the materiality implementation seems to be at its early stage, mainly due to both the non-mandatory profile of the concern and the lack of users’ knowledge. In this context, several challenges related to the information’s relevance are creating a gap between the IIRC suggestion and real firms’ capabilities in data disclosure.

The analysis emphasized in the third chapter is related to the information connectivity, an issue which could be addressed once the materiality has been solved. In this case, the literature references that could have been taken into account are very few, due to the extreme complexity of the topic. Establishing the connectivity among data requires the organizations to being aware of their value creation process, structure, strategy and future objectives. Moreover, not only a high level of awareness and disclosure is required to the companies, but also they are not provided with clear guidelines to evaluate their level of connectivity, leaving the decision making process at their complete discretion. Since the connectivity is essential to draw up a real Integrated Report, the majority of companies are struggling with this issue.

The last chapter is based on the assurance analysis mainly for the non-financial information. Nowadays, a large amount of both academics and auditors are focusing their energy in dealing with the assurance of non-financial data, which appears to be a real complex goal to achieve since the Integrated Report requires the disclosure of both qualitative data and future ones, which for their nature cannot be ensured by auditors. Several models to evaluate the pre-financial information have been described in this section, even if a really helpful and trustful assurance method has not yet been identified, leaving future opportunities for development.

The whole work has been developed with the aim of analysing the two side of the same topic: the possibility of developing a new reporting process which could benefit the society as a whole and the real critical perspective that the organizations have to face with in order to align their current corporate reporting process to the desired one.
1 Integrated Reporting

1.1 Non Financial Voluntary Disclosure

Before introducing the theme of Integrated Report, it could be beneficial to analyze the milestones at the basis its formulation, starting from the concept of corporate disclosure. Disclosing corporate information results to be a really tough point to face with, in order to maintain the efficiency of the capital market. Two main arguments enhance the relevance of corporate disclosure: firstly, the capital providers need information to evaluate the firms’ value and to catch investment opportunities, secondly, the same shareholders and creditors require pieces of information to capture whether the firms are allocating their resources in an efficient way. In this context, it is possible to relate these arguments to an unique issue: the “lemons problem” identified by Akerlof in 1970. In his paper, the author stated that under a condition of information asymmetry, the same situation usually existing between capital providers and firms’ managers, the party which owns more and high-quality information (in this context firms’ managers) could exploit the asymmetry for its own interest, behaviour which is defined as moral hazard. As a consequence, in order to avoid both the information asymmetry and to increase the level of reputation and market consensus, the firms’ managers should disclose information.

There exist three types of information disclosure: mandatory and voluntary disclosure, financial and non financial information, and forward-looking and backward-looking information. For the purpose of the work, the focus is going to be on voluntary non financial information, which implies a forward-looking approach. According to Meek, voluntary disclosures “represent free choices on the part of the company managements to provide accounting and other information deemed relevant to the decision needs of users of their annual report”. It is obvious from the previous definition that voluntary disclosure aims at improving the quality of information.
possessed by professionals involved in the decision-making process. Taking into account one of the main objectives of a firm, maintaining its ability to attract investments, it should be in the best interest of firm’s managers to disclose information voluntarily, in order to allow capital providers to make more informed decisions. So, on one hand, disclosing information voluntarily enhances the companies’ credibility and reputation to the market, but the on the other hand, an issue related to disclosure arises. It consists in the risk of losing competitive advantage due to the public disclosure of sensitive information, risk which should be mitigated by the managers, aware of which should be the data to maintain internally to the firm.  

Voluntary information disclosed could be both financial and non-financial, but as it was already stated, non financial information is going to be investigated. “Non financial information could regard social, human and environmental disclosure”, as reported by Demartini and Trucco in their analysis. Similarly, in the Directive 2014/95/EU non financial constituents are considered to be “as a minimum, environmental, social and employees matters, respect for human rights, anti-corruption and bribery matters”. Both the definitions focus on three main areas: social, environmental and human field, implying that non financial data are not only addressed to capital providers, but they are also directed to a broader audience. From a theoretical perspective, the audience, which could both contributing at and benefitting by the firms’ activities, and as a consequence is really interested in a large variety of information, is composed by several stakeholders. This concept was firstly idealized by Freeman, in his “Stakeholder View” in 1984. According to the author, the firms should not focused on maximizing the value perceived only by the shareholders, but they should increase that value perceived by all stakeholders. As a matter of fact, the firms are required to be accountable for their activities with respect to a broader public, implying that the pieces of information needed by several types of stakeholders, are different. In this context, the voluntary non financial information disclosure becomes relevant to satisfy the stakeholders’ requirements. A problem related to the non financial data disclosure, is caused by the lack of international regulations and standards which ensure the reliability

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8 Freeman Edward (1984), “Stakeholder View”
of information provided by the firms. This issue would be analyzed in more details later in the work (Chapter 2).

At last, the forward-looking approach has to be explained. To clearly understand the forward-looking approach it could be helpful compare it with the backward-looking approach, typical of the traditional annual report, especially for the financial statements. It is well-known from the economic theory that financial data, regarding past events, are recorded in the annual report. In fact, both global accounting regulators and standard setters, such as the International Accounting Standard Board (IASB) agree on the fact that firms have to report financial information occurred in the last fiscal year, in order to ensure the comparability of information among firms. A different time horizon is suggested when the non financial information has to be published. It is possible to report non financial data about activities already performed by the companies, but it would be more advantageous to provide stakeholders with non financial advice about companies’ future purposes. The reason why the forward-looking approach should be preferred to the backward-looking one, lies on the fact that stakeholders are more interested in the future value which the firms are supposed to generate, instead of focusing only at the past performance, which could be helpful to capture whether the activities are run properly, but cannot be useful to comprehend the firms’ ability both to face and to adapt to environmental and social changes, maintaining its capability of creating value. However, the main drawback related to the forward-looking approach deals with the reliability of information; as a matter of fact, the external professionals cannot completely trust the forward expectations, due to their nature. The expectations are necessary to predict the future desired value of the firm but, at the same time, the data are projections, implying that there will be always an intrinsic risk of failure in reaching the future targets.

In the following scheme, the benefits and the disadvantages related to each dimension discussed so far, are simplified.
### Benefits

<table>
<thead>
<tr>
<th>Voluntary information</th>
<th>Non-financial information</th>
<th>Forward-looking approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increasing firm’s attractiveness;</td>
<td>Firm maximizes the shareholders’ value;</td>
<td>Opportunity to comprehend firm’s future ability to generate value.</td>
</tr>
<tr>
<td>Enhancing firm’s credibility and reputation.</td>
<td>Increasing the accountability of firm with respect to social and environmental issues.</td>
<td></td>
</tr>
</tbody>
</table>

### Drawbacks

<table>
<thead>
<tr>
<th>Voluntary information</th>
<th>Non-financial information</th>
<th>Forward-looking approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk of losing competitive advantage.</td>
<td>Lack of international standards causes low reliability of information.</td>
<td>Difficulties in comparing information; Reliability of future expectations.</td>
</tr>
</tbody>
</table>

Table 1- Information Disclosure: Benefits and Drawbacks

1.2 Antecedents

Once firms understood that voluntarily non financial information disclosure would become more and more relevant in the accounting practices, some antecedent of the Integrated Report have been developed. In the last 20 years the literature has described three main forms of reporting prior to Integrated one: the Balance Scorecard, the Triple Bottom Line approach and the Sustainability Report. Even if these reporting tools are different, their aim is the same: increasing the level of non financial information disclosure in the market.

1.2.1 Balance Scorecard

The first system developed to combine financial and non financial data was formulated by Kaplan and Norton in 1996, and it was defined Balance Scorecard. It was a firm’s internal system, meaning that its purpose consisted mainly in supporting the managers during their activities of directing and monitoring the firm’s internal

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operations. The authors pursued several objectives during the formulation of this management system. First of all, they aimed at linking the firm’s strategy to the financial and non financial measures used to evaluate its performance. Secondly, through the application of both financial and non financial measures, they aspired at mixing short-term firm’s orientation with the long-term one. At the end, the main goal to be achieved consisted in using non financial measures to predict future financial results. With respect to the traditional management system, the Balance Scorecard architecture is based on four different perspectives, which should be taken into account by the managers, during the company’s evaluation. For each perspective the professionals have to identified the desired objectives and the measures that they are intended to adopt to evaluate their activities\textsuperscript{10}. In fact, “A good balanced scorecard should have a mix of outcome measures (lag indicators) and performance drivers (lead indicators)\textsuperscript{11}”, in order to establish the cause-effect relationship, which is extremely important to transform the Balance Scorecard in a really efficient tool.

The starting point for building this internal management system is the financial area. Kaplan and Norton stated “The financial performance measures define the long-run objectives of the business unit”, so through the financial data the companies have to define their expectations about their future ability of generating profits, so in more general terms, their ability to create value for shareholders. The financial objectives, that firms want to achieve, depend on the stage at which the organization is operating: it could be at its early stage, at its steady-stage or at its maturity stage. Considering these scenarios, the firm has to focus relatively on “rapid growth, cost reduction and asset utilization”. The type of information required is the financial one.

The second perspective described by the authors is the customer one, in which “managers identify the customer and market segments in which the business unit will compete and the measures of the business unit’s performance in these targeted segments”. In this context, the firm’s managers have to comprehend how they are able to create and deliver their value proposition to the customers. Kaplan and Norton suggested several measures that could be adopted to relate the internal performance to external conditions, such as: “customer satisfaction, customer retention, new customer


acquisition and market share”. In the customer perspective, the non financial information are necessary to describe the value proposition perceived by customers. As a matter of fact, the clients are not only interested in the products’ quality, design and price, but also in the purchasing experience and brand’s reputation and image. For this reason, it is extremely relevant to point out both the financial measures related to customers, such as the forecasted level of sales, and non financial measures, such as questionnaires to capture the customers’ loyalty.

The internal business process constituents the third perspective of the Balance Scorecard. In this context, the companies should understand which internal operations are relevant for their success. They have to highlight which activities are critical and how these processes can be improved, in order to ensure their excellent execution. Two types of activities have to be analyzed: the existing projects and the innovative ones, to pursue the objectives both in the short-term horizon and in the long-term one. The suggestive question to which the professionals have to answer, to complete this area, is the following one: “to satisfy our shareholders and customers, what business processes should we excel at?” The information disclosed in this context are both financial and non financial, as for example, products’ quality measurement or identification of customers’ needs through web survey.

The last block of the Balance Scorecard is composed by the learning and growth process. To be successful in the future, the companies have to able to adapt themselves to market changes and different customers’ trends. To be adaptable, the firms should recognize their strengths and weaknesses, as well as the market’s opportunities. In order to be flexible, they should be aware of how the learning process works and how they have to avoid to fall in the “learning trap”\textsuperscript{12}, which will caused their inability to seize profitable opportunities. For this reason, companies have to embrace the development process in three main directions: “people, systems, and organizational procedures”. All these three sources strongly influence the firm’s development and its responsiveness to market changes. In this perspective, the pieces of information required are for the majority non financial, due to the relevance held by the employees in this category.

At the original system developed by Kaplan and Norton, it was later added another component, the sustainability one. The following system was named

Sustainability Balance Scorecard\textsuperscript{13} due to its new perspective, based on sustainable measures.

\subsection*{1.2.2 Triple Bottom Line Approach}

The Balance Scorecard system was the skeleton of the Triple Bottom Line approach, firstly described by Elkington in his book \textit{“Cannibal with forks, the Triple Bottom Line of 21st century business”}. According to the author, since 1980 the governments started losing their power, while the international institutions became more influencing in the market, and as a consequence, all the companies have been required to be accountable for their actions in several fields. In this context, the Triple Bottom Line approach (TBL) was introduced, becoming a milestone for its \textit{“3Ps: People, Profit and Planet”}. Firms were asked to be responsible not only for their operations with respect to the shareholders, but also with respect to their stakeholders. In his work, Elkington emphasized three main points\textsuperscript{14}:

1. The need for a new set of values; \textit{“It is no longer a question about hard, predetermined rigid values. We are tending towards 'world citizen' values where quality replaces quantity and a long-term reflection becomes an obligation”}.

2. The increasing role of transparency; \textit{“Thanks to the development of information technology, businesses' actions become increasingly visible. Sustainability reporting becomes an important tool to give a clear image of a company and also to make it comparable with others”}.

3. The difficult time-horizon; \textit{“On one hand companies have to act as quickly as possible while the transmission of information becomes immediate. On the other hand, the long-term view requires greater attention as foresight is an essential indicator of sustainability”}.

The TBL approach has been perceived as a sort of answer to these issues, in fact it could be possible to better explain the approach through the words of other authors, Glavas and Mish, who stated \textit{“TBL firms offer a model for understanding how businesses can

\textsuperscript{13} Hansen G. and Schaltegger S. (2016), \textit{“The Sustainability Balanced Scorecard: A Systematic Review of Architectures”}, Springer Science+Business Media Dordrecht

\textsuperscript{14} Berkovics D. (2010), \textit{“Fiche de lecture - Cannibals with forks 21st The triple bottom line of century business”}. Alternative Management Observatory
address environmental and social goals while also being profitable\textsuperscript{15}. Therefore, from previous definitions it is clear that the TBL concept has been established to overcome the merely financial measures, typical of the traditional accounting report, to enforce the attention on social and environmental issues. TBL is considered as a new accounting framework, which aims at assessing the firm’s performances from several points of view. For this reason, the professionals are required to identify the indicators through which they would evaluate the firms’ operations. The lack of international standards and rules, which could define the key indicators for TBL approach, constitutes both an advantage and a drawback for all the firms which intend to adopt it. On one hand, each company is free to set its own index useful for the evaluation, but on the other hand, finding really meaningful indicators is becoming a significant concern to face with. An helpful tool for the companies could be the paper\textsuperscript{16} of two American analysts, who tried to describe the three dimensions with some examples of the relative indicators. The Economic values used can be described as those variables which are able to represent the firms’ cash flows. The Environmental variables include the natural resources adopted by the companies, and those factors that could have a strong impact on areas in which the organizations are operating. The Social measures “refer to social dimensions of a community or region and could include measurements of education, equity and access to social resources, health and well-being, quality of life, and social capital”. Nowadays the TBL approach is adopted by the companies which are interested in reporting their both their financial and their non-financial results. The TBL approach has introduced the Sustainability as a core concept for the organizations.

1.2.3 Sustainability Report

From the previous cases, it is possible to capture that the relevance of sustainable factors (both environmental and social) is increased in the past years, requiring the organizations to adapt their public reports to the new market’s needs. In this context, the Sustainability Report was introduced in order to support the traditional financial report in disclosing non-financial data. In fact, accounting practices were developed to identify how non financial factors could have a strong influence in the long-term economic

\textsuperscript{15} Glavas A., Mish J. (2015), “Resources and Capabilities of Triple Bottom Line Firms: Going Over Old or Breaking New Ground?”, J Bus Ethics

perspective\textsuperscript{17}. At international level, several regulatory bodies have promoted both the standards’ development and the guidelines for the preparation of the Sustainability Report. The most important bodies are the Global Reporting Initiative (GRI) and the AccountAbility one. The first entity describes its actions in its website: “\textit{GRI helps businesses and governments worldwide understand and communicate their impact on critical sustainability issues such as climate change, human rights, governance and social well-being}\textsuperscript{18}”, while the second one defines itself as “a global consulting and standard firms that works with business, governments and multi-lateral organizations to advance responsible business practices and improve long term performance\textsuperscript{19}.”

First of all it would be appropriate to provide a definition for Sustainability Reporting in order to comprehend how it is perceived by the regulatory entities: “\textit{sustainability reporting is the practice of measuring, disclosing, and being accountable to internal and external stakeholders for organizational performance towards the goal of sustainable development}\textsuperscript{20}”. As a consequence, the Sustainability Reporting aims at being a relevant tool both for internal stakeholders and for external ones, ensuring that all the undertaken activities are performed in a sustainable way. Once the role of Sustainability Report (SR) has been clarified, it is required to specify which are the most important guidelines through which the organizations prepare the report. The main support is provided by both the GRI’s standards G3 and G4, and the AccountAbility’s rules AA1000APS. For a clear description of the principles followed by the firms, it would be better to focus only on the G3 and G4 Sustainability Reporting Guidelines. Two categories of principles\textsuperscript{21} are identified:

1. Principles for defining Report content:
   i. Stakeholder Inclusiveness: “\textit{The organization should identify its stakeholders, and explain how it has responded to their reasonable expectations and interests}”.
   ii. Sustainability Context: “\textit{The report should present the organization’s performance in the wider context of sustainability. How an organization contributes, or aims to contribute in the future, to the improvement or deterioration of economic,}

\textsuperscript{17} Unerman (2014), “\textit{Academic contributions to enhancing accounting for sustainable development}”, pp. 385–394, Accounting, Organizations and Society No.39
\textsuperscript{18} GRI website, https://www.globalreporting.org/information/about-gri/Pages/default.aspx
\textsuperscript{19} AccountAbility website, http://www.accountability.org/about-us/about-accountability/
\textsuperscript{20} GRI (2006), “\textit{G3, Sustainability Reporting Guidelines}” p.4, GRI website
\textsuperscript{21} GRI (2015), “\textit{G4, Sustainability Reporting Guidelines}”, pp.16-18, GRI website
environmental and social conditions, developments, and trends at the local, regional or global level”.

iii. Materiality: “The report should cover Aspects that: reflect the organization’s significant economic, environmental and social impact; or substantively influence the assessment and decision of stakeholders”.

iv. Completeness: “The report should include coverage of material Aspects and their Boundaries, sufficient to reflect significant economic, environmental and social impacts, and to enable stakeholders to assess the organization’s performance in the reporting period”.

2. Principles for defining Report quality:

i. Balance: both positive and negative aspects have to be disclosed by the organization, in order to ensure a fair representation of its situation and to allow an unbiased assessment for the stakeholders.

ii. Comparability: the pieces of information reported should be comparable both over time and over other organizations, as a consequence the firm has to disclose data to ensure that stakeholders make comparisons.

iii. Accuracy: the data should be reported in detail, in order to allow stakeholders to make an accurate performance’s evaluation.

iv. Timeliness: the report should contain updated information so that the stakeholders could make informed decisions.

v. Clarity: the language adopted should be understandable and accessible to stakeholders, in order both to enhance comprehension and to avoid misunderstandings.

vi. Reliability: the data provided by the organization should be verifiable and trustable for stakeholders, as a matter of fact the data should reflect the contents’ quality and materiality.

Moreover, the Boundary Setting is essential during the preparation of SR. In fact, the “Sustainability Report Boundary should include the entities over which the reporting organization exercises control or significant influence both in and through its relationships with various entities upstream (e.g., supply chain) and downstream (e.g.,
distribution and customers)”. As a consequence, the information disclosure process could become difficult if the firm is not able to recognize that different relationships with other entities require different degree of available data and several types of information disclosure\textsuperscript{22}. The SR has become a really helpful tool for all the companies inclined to purse not only the economic profitability but also the sustainable development of the activities.

To summarize the concepts of the previous reports and frameworks adopted in the last years, the relevance of non-financial information has arisen, forcing the organizations to be accountable for both internal and external stakeholders in disclosing both financial and pre financial information. Especially the Sustainability Report seems to be the real antecedent of the Integrated Report, which is going to be explained in the next sections.

1.3 IR Frameworks

The antecedents described in the previous section have oriented the accounting practices into a different way of disclosing information. From the Balance Scorecard it was really clear that both financial and pre-financial data are necessary at firms’ internal level, in order to allow managers to make more informed decisions. From the Triple Bottom Line approach, the importance of all the stakeholders is highlighted, while from the Sustainability Report, the increasing role of both environmental and social issues is emphasized. Moreover, the current globalization and the continuous technology development, are forcing the companies to be more competitive and more accountable for their actions, as well as to provide the market with useful and readable information at a rapid pace. For this reason, a comprehensive document has been developed for the companies, in order to allow them to be both responsible for their actions and ready to provide the necessary information. The paper is named Integrated Report, and its improvement is currently run by several entities. It would be appropriate to provide an excursus about the Integrated Report’ development before trying to define its structure and its contents. From an historical point of view, an initial draft of the current Integrated Report (IR) was introduced in South Africa in 1994. The report was considered to be an answer to the needs for enhancing the level of social and economic equalities, in fact due to the apartheid ending, the firms were strongly recommended to

\textsuperscript{22} GRI (2006), “G3, Sustainability Reporting Guidelines” p.18-20, GRI website
provide the country with non-financial information, in order to ensure their commitment to a new social and economic situation. The documents edited by the South Africa country were three, defined as King Reports: King Report I (1994), King Report II (2002) and King Report III (2009). For the purpose of this work, it would be better to focus the attention on the last report drafted, the King Report III. It has introduced for the first time the idea of integrated thinking, “promoting the concept that strategy, governance and sustainability are intimately entwined”. As the authors De Villiers, Rinaldi and Unerman explained in their academic paper, the impact of the King Report III developed in the South Africa, was so strong that the Johannesburg Securities Exchange adopted the Report’s main principles as requirements to fulfil for listed companies. As a matter of fact, the financial and non-financial combination of data became essential for the capital market, and the “comply or explain” approach was introduced as well. The companies listed in the Johannesburg Securities Exchange, had to provide their financial and pre-financial information or to explain the reasons why they did not do. A subsequent King Report has been developed, King Report IV, which is currently adopting the principles provided at global level.

In the meanwhile, several global bodies have focused their attention on the non-financial values. The United Nations Global Compact (UN Global Compact) is an organization which describes itself as “A call to companies to align strategies and operations with universal principles on human rights, labour, environment and anti-corruption, and take actions that advance societal goals”; therefore, even if the entity’s aim does not consist in defining the IR’s principles, it has developed some relevant features which would be introduced in the IR framework later. The UN Global Compact’s efforts are addressed to protecting ten essential principles, concerning four different areas, which are already expressed in the initial mission: Human Rights, Labour Standards, Environment and Anti-Corruption field. The principles are so powerful that it would be better to report them as they are, in order to avoid their underestimation:

26 Un Global Compact website, https://www.unglobalcompact.org/what-is-gc
1. Human Rights, based on the Universal Declaration of Human Rights\(^\text{28}\)
   i. “Business should support and respect the protection of internationally proclaimed human rights”.
   ii. “They should make sure that they are not complicit in human rights abuses”.

2. Labour Standards, based on the International Labour Organization\(^\text{29}\)’s fundamental principles and rights at work
   i. “Business should uphold the freedom of association and the effective recognition of the right to collective bargaining”.
   ii. “The elimination of all forms of forced and compulsory labour”.
   iii. “The effective abolition of child labour”.
   iv. “The elimination of discrimination in respect of employment and occupation”.

3. Environment, based on the Rio Declaration on Environment and Development\(^\text{30}\)
   i. “Business should support a precautionary approach to environmental changes”.
   ii. “Undertake initiatives to promote greater environmental responsibility”.
   iii. “Encourage the development and diffusion of environmentally friendly technologies”.

4. Anti-Corruption, based on UN convention against corruption
   i. “Business should work against corruption in all its forms, including extortion and bribery”.

The ten principles supported by the UN Global Compact, are drawn up in order to enhance a sustainable way of doing business both from an economic point of view and from a social and environmental ones.

As already stated, another international entity that has promoted standards about sustainability way of running activities, is the GRI. It founded the International


Integrated Reporting Council (IIRC) in 2010\textsuperscript{31}, which was responsible for the main framework realized for the Integrated Report. The IIRC is considered as a “\textit{global coalition of regulators, investors, companies, standards setters, accounting professions and NGOs}”\textsuperscript{32} that want to achieve a higher level of communication about how firms are able to generate their value, so the regulatory body aims at improving the corporate reporting process. To reach this goal, IIRC decided to start a two-years project in 2011, called “\textit{Pilot Programme}”\textsuperscript{33}. The coalition has selected the companies taking part at the project both on the basis of how they run activities, as a matter of fact they were considered well-performing companies, and on the basis of their willingness to develop best practices that will be accepted at global level. The firms were chosen from all around the world, from different sectors and industries in order to obtain comprehensive and complete principles through which the IR could have been composed later.

The Pilot Programme was really interested for its own nature: the companies themselves were free to identify some best standards, which usually are imposed by external regulatory bodies without considering the firms’ point of view. The process of IR’s guidelines identification was conducted in an opposite way with respect to the traditional one, allowing the companies to be both an active part in defining the standards and to be more committed to the IR paper. The final results were collected in 2013, when the ultimate document was drawn up. It is called \textit{<IR>} and it includes the most important features, both in terms of structure and in terms of contents, that organizations can follow during the preparation of the report. The \textit{<IR>} paper could be perceived as a strong innovation in terms of corporate reporting process, due to its direction to sustainable business. As it was mentioned earlier in this work, also the European Union is robustly supporting the non-financial information disclosure thorough the European Directive 2014/95 stating “\textit{Large undertakings which are public-interest entities...during the financial year shall include in the management report a non-financial statement containing...non-financial key performance indicators relevant to the particular business}”\textsuperscript{34}.

\textsuperscript{32} IIRC website, https://integratedreporting.org/the-iirc-2/
However, even if the international bodies are working on the formulation of principles that could be used by the organizations to disclose non-financial data combined with the financial ones, the only standards considered mandatory so far, are those published in the European Directive, implying that the regulatory entities have put a lot of efforts in improving the reporting process, but a formal and legal acceptance of their principles is still missing. As a direct consequence, the companies are not so strongly motivated in providing their non-financial data because the standards that they could use are formally compulsory, meaning that the information provided will be neither controlled nor ensured. Therefore, disclosing non-mandatory information would be both a cost and a time-consuming process for the firm; so the benefit of this information disclosure, which enhance the firm’s trust and reputation, will not outweigh its drawback.

1.4 IR definition and adoption

Once the frameworks available for the preparation of the IR have been described, it would be well-timed to provide a definition of what the Integrated Report is, in order to comprehend how it could work and how the firms could take advantages from its usage.

It would be appropriate to report the definition identified by the most involved coalition in the report’s formulation. The IIRC has stated: “An Integrate Report is a concise communication about how an organization’s strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value over the short, medium and long term”. By the statement analysis it is possible to pinpoint some features related to the IR that can be depicted as completely innovative with respect to the traditional definition of financial statement provided by International Financial Reporting Standards (IFRS), which can be described as “…the main users of financial statements are investors (existing and potential); the investors’ main objective is to make economic decisions; this means that they need to predict an entity’s future cash flow; so, financial reporting should provide understandable, relevant, reliable and comparable information for this purpose”. It would be advantageous to collect the differences of the two approaches according to three main

dimensions: the content of the reports, the audience to which they are directed to and the time to which information is referred to.

Taking into account the reports’ contents in general terms, the IR is supposed to be a “concise communication”, implying that, in the best scenario, the organization should be able to express all its relevant information in just few pages; while the financial statement usually is a long document because it has to contain the Balance Sheet, the Income statement and Profit and Loss statement, in order to provide the “existing and potential investors” with a complete financial picture of the firm’s condition. Taking into account the firms’ point of view, disclosing information in few pages is a real complex and expensive task, because it requires well-developed ability in recognizing relevant matters, as well as in synthesizing the data discovered.

Secondly, IR should report the “organization’s strategy”. The strategy could be easily defined as “the choice of business model through which the firm will compete in the marketplace”; as a consequence, the firms have to provide the market with their information about their desirable objectives and how they intend to pursue them. The same item is not required to be disclosed in the financial statement, apart from the actions needed to reach the “entity’s future cash flow”. A possible observation that could be made is concerning the firm’s competitive advantage. In fact, usually the organizations prefer to consider the strategy as a internal information, due to the fact that disclosing some sensitive data, related to the plan of actions, could reduce the firms’ competitive advantages with respect to their competitors. The same risk is not showed by the financial reporting activities, because the firms could decide to provide only aggregated financial data, avoiding to disclose sensitive ones.

Another element of innovation for the IR, is the disclosure of “organization’s governance”. The governance of an organization can be described as follow by the OECD body: “procedures and processes according to which an organization is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the organization and lays down the rules and procedures for decision making”. The corporate governance adoption is becoming relevant in the largest organizations both to prevent that illegal events could occur and to protect all firm’s stakeholders. A similar requirement is not needed in the

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38 OECD website, http://www.oecd.org/general/searchresults/?q=corporate%20governance&cx=012432601748511391518:xzeadb0 b0a&cof=FORID:11&ie=UTF-8
financial statement disclosure. As a matter of fact, in the traditional financial report a scheme related to the organizational hierarchy (organization’s structure), is provided to the audience, but the complete management of the firm, included all the committees and the Board of Directors’ composition and backgrounds, is not treated as a public information. The introduction of the corporate governance feature in the IR, has raised the responsibility of those people who cover the most powerful positions in the firm’s structure, considering them responsible for both “economic decisions” and all the other non-financial issues to manage.

The IR requires the companies to disclose their data about their “performance and prospects”, implying that the mainly financial results already reached and the future targets have to be both provided to the external market. This feature is the only one which could be considered as quite similar to the traditional financial statement’s requirements, due to the fact that the financial report has to publish this type of data to allow investors to make the best economic decisions.

Apart from the IR’s content, which is proved to be mostly different from the financial statement’s one, other two relevant dimensions have to be analyzed: the audience to which the reports are addressed to and the time to which information is referred to. A common feature is identified in the audience of the reports. In fact in both cases, the audience consists of both the internal and the external stakeholders. The only note that can be made concerns the extent of the audience; on one hand, in the case of the Integrated Report all stakeholders (investors, employees, communities, institutions and regulatory bodies) are equally considered deserving the data, while, on the other hand, the financial statements is mainly addressed to existing and potential capital providers. The last perspective taken into account, is strictly related to the time period to which the data should be referred to. In the IIRC definition, it is clear that the data should be provided for the “creation of value over the short, medium and long term”, meaning that it is not enough to provide information about how the organization is generating value in the current period, but it is necessary to adopt a forward-looking approach. In the opposite, the financial statement reports the financial data related to the previous fiscal year, using a backward-looking approach, already described in the section 1.1.

Even though the IIRC’s definition is the most widespread, the Integrated Reporting Committee of South Africa (IRCSA), has provided its own description of what IR is and which is its purpose: “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 organizations’ 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\textsuperscript{39}. In the analysis of this statement, some new and relevant elements are highlighted, particularly the connection and the comparability of data. IRCSA is underlying that it would be necessary to connect social and environmental information to the economic one, as well as it should be appropriate to provide a term for comparison. Satisfying these requests appears to be a long and expensive process for the organizations, which have to comprehend the link between all their available data and disclose them in a comparable way, which is extremely difficult due to the fact that high-quality and mandatory standards have not yet been adopted at global level. As a consequence, the Integrated Report could be perceived as an innovative tool for its requirements of firms’ accountability and information disclosure, but the organizations are not enough incentivized to prepare the Report for several reasons: the IR’s international framework provided by the IIRC is not mandatory from a legal point of view, so it is a company’s decision whether to use the framework or not; the companies have to demonstrate a high level of internal comprehension of the activities performed, which is a really tough issue to manage; and, a high level of expenditure is required to publish the IR, which could be a problem for small and medium size companies.

Once the definition of IR has been provided, it would be interesting to focus the attention on the five main steps through which the organizations have to move in order to prepare the IR. The steps are clearly examined in an academic paper of J. Burke and E. Clark\textsuperscript{40}. According to the authors, the first step that should be undertaken consists in developing the integrated thinking concept within the firm. “\textit{Integrated thinking takes into account the connectivity and interdependencies between the range of factors that affect an organization’s ability to create value over time}\textsuperscript{41},” as a consequence, the firms have to capture which are the factors that influence their ability to create value in order to have a broader picture of what they have to disclose later. This is a complex and long process, which should start from the top-management of the companies, in order to

\textsuperscript{39} Demartini C., Trucco S. (2017), \textit{“An empirical analysis in the European setting”}, Integrated Reporting and Audit Quality, Chapter 2, Springer
\textsuperscript{40} Burke J., Clark E. (2016), \textit{“The business case for integrated reporting: Insights from leading practitioners, regulators and academics”}, Business Horizons
ensure that all the organizational culture and behaviour can change. Once the firm is comfortable with its relevant elements, it could proceed to the second step. The second stage expressed by Burke and Clark could be summarized as “utilize available guidance”. From the previous sections it is known that there are not existing mandatory standards to follow for the preparation of the IR, implying that the “early adopters of IR” have a great opportunity: they could boost the IR’s principles development, fostering the best-practices to be adopted. At this point, the firms are involved in the most difficult process: gathering information and determine which data should be disclosed. As a matter of fact, companies have to deal with a huge amount of data if all economic, social, environmental, past and future information has to be taken into consideration. The authors strongly suggest to use the IIRC’s framework, in order to avoid to get lost in the data collection phase. The fourth step proposed is related to the type of audience to which the IR have to be direct to. The information has to be disclosed properly on the basis of the audience, understanding which stakeholder needs which data. A last effort is required to the organization, trying to ensure the truthfulness of information provided. The assurance issue would be discussed later in this work; so far it is possible to state that ensuring the information quality represents one of the major challenges for the companies.

Once the IR’s definition and its general preparation process have been explained, the benefits that the firms could collect, have to be mentioned. An initial distinction has to be drawn: firms’ internal benefits and firms’ external ones.

1. Internal Benefits:
   i. As already explained, before the IR preparation, firms have to be aware of the main activities at the basis of their value creation process, meaning that the companies should have a very deep knowledge of which are their relevant operations, generating a more efficient resource allocation process.
   ii. The integrated thinking at the basis of IR requires a high level of internal communication among departments, in order to overcome the “silos structure” of the organization.

iii. Providing not only financial data would decrease the “reputational risk” of the organization, and it would raise the quality of decision-making process.

2. External Benefits:
   i. Potential capital providers are better informed on the firms’ condition, so they would be more willing to provide investments.
   ii. Several stakeholders are involved in the communication of information, for this reason, the level of information asymmetry is reduced and the stakeholders engagement is increased.

The reader does not have to think that the IR’s adoption would bring only advantages to the companies; in order to provide a more truthful picture of what the firms have to face with when they adopt the IR, it would be appropriate to explain the issue related to the topic, which will be described in the last section of this chapter.

1.5 IR preparation

The companies which have decided to provide the external market with their Integrated Report, are in some way forced to use the IIRC’s framework, in order to avoid the principles’ development by their own. In the following sections both the main guidelines of IR and its contents are going to be analyzed.

1.5.1 IR Guiding Principles

Before proceeding with the introduction of Guiding Principles of the Integrated Report, it would be better to emphasize the fact that the <IR> is a “principles-based” framework. The principles-based approach presents some particular features which are in contrast with those showed by the rules-based approach. On one hand, the principles-based approach aims at maintaining the flexibility within an organization, due to the fact that it does not impose statutory requirements. It provides general guidelines which could be slightly changed on the basis of the environment in which the firm is operating. On the other hand, the rules-based approach is forcing the companies to be legally accountable for their data provided. They are two different approaches, each one with benefits and disadvantages for the organizations. As a matter of fact, even if the principles-based approach seems to be more adaptable to several situations, the lack of mandatory rules to follow, could cause a less transparent information communication,

generating meaningless information disclosure. In the same way, fixing a rigid set of rules to follow, could encourage firms to act against the law, trying to mislead and confuse the audience in order to not provide the data demanded. So the IR is a principles-based framework, and the IIRC has defined some basic guidelines called: Guiding Principles. At the basis of the Guiding Principles formulation lies the integrated thinking concept, already introduced in the previous section. As a consequence, all the Principles aim at providing a complete picture of the firms’ value creation process. The Guiding Principles are six and they are going to be synthesized in the following part:

**Strategic Focus and Future Orientation**

The first Guiding Principle consists of providing a relevant description of which the firm’s strategy is. For the first time the companies have to disclose data about how they intend to create value and, therefore, they disclose not only their strategic objectives, but also their business model. “The definition of the business model is also central...it is seen as a very important element for investors in order to assess the ability of the company to create and sustain value over time”, in this way the relevance of the business model could be introduced. The business model concept is well-known from a theoretical perspective thanks to the contribution of Osterwalder A. and Pigneur Y. with their book “Business Model Generation”. The book presents the theory of the nine-building blocks through which the organizations can easily build their business model canvas, including all the needed elements which are: “Customer Segments, Value Proposition, Channels, Customer Relationships, Revenue Streams, Key Resources, Key Activities, Key Partnership and Cost Structure”. The business model “describes the rationale of how an organization creates, delivers and captures value”. In a similar way the <IR> framework provides a definition of how it perceives the business model: “business model is the system of transforming inputs through its business activities into outputs and outcomes that aims to fulfil the organization’s strategic purposes and create value over the short, medium and long term”. Even if from the first definition it is obvious what a business model represents, in the second one, two interesting innovative elements have to be evaluated: “outputs and outcomes”. For the first time,

the distinction between output and outcome is introduced in a framework, and as a consequence, in the report. The output, which can be a tangible product or a service, can be described as the immediate result of the firm’s activities, so, the output is the organizational source of revenues. The outcome is a step forward, it is the “impact” which the firm could generate both internally and externally. It could be really complex to comprehend what the outcomes really are, especially from an internal point of view. In fact the organization has to capture how it is influencing its own resources, both physical and intellectual, and its own processes; moreover, it has to understand how it is affecting the environment in which it is operating, from an economic, social and environmental point of view. The introduction of these two features is extremely important for the formulation of the IR, because the firms have to keep constant in their vision both what they want to achieve, and what they are doing, how they are acting with respect to external environment.

Strictly related to the concept of outcomes it is the future orientation, second part of this first Guiding Principle. The firms have to disclose how they will use their inputs to produce their outputs and outcomes in the long term perspective. The forward-looking approach is at the basis of the future orientation formulation. IIRC describes the future orientation as “how the organization has learned from past experiences in determining future strategic directions49”. The future orientation approach is not only useful in terms of economic activities of the firm, but it could be also really helpful in managing the internal stakeholders of the organization, such as employees and managers. To explain the concept, it would be better to just introduce some parts of a recent psychological theory, “Emotional Intelligence”, supported by Goleman D.. The author has stated that at the basis of the emotional intelligence there are some competencies, defined “discretionary”, which overcome the traditional competencies based on the technical knowledge or expertise. The discretionary competencies consist of emotional and social competencies and they can be developed by every person. For the purpose of this work, it would be appropriate to focus the attention on just one competence among others: “hope”, which in psychological terms can be explained as: “una combinazione tra la capacità di articolare con chiarezza i propri obiettivi, la convinzione di poterli ottenere, la messa a punto di un progetto di azione e la capacità di raggiungere i propri scopi provando un senso di benessere come risultato dell’intero

processo"). According to the definition, it seems quite clear that hope could have a relevant role within the companies, both in the selection process conducted by the HR department and in the people management process. Focusing on hope for the future would increase the willingness of people to act in order to reach the objectives. The companies which are operating in extremely uncertain environments need people who possess hope as a discretionary competence; firms need employees who are able to motivate themselves to achieve the firms’ targets, acting with a scope while transmitting positive feelings to other people. From an organizational point of view, future orientation could be linked to the hope competence, using the latest element as a motivational tool to use internally.

To summarize, the firm’s strategy and its future plans are becoming relevant in the preparation of IR, however, both dimensions are really difficult to establish from an internal point of view, and the information related to them could be really sensitive to disclose. Moreover, making forecasts about future expectations, requires managers to be responsible for their evaluations, and to be aware that there will be always a risk related to the market uncertainty.

**Connectivity of Information**

The second Guiding Principle consists of “connectivity of information”, which could be perceived as a real innovative element with respect to the traditional report. IIRC emphasizes the fact that information should be combined in order to provide an “holistic picture” of how organizations generate value. As previously stated, also at the basis of connectivity of information there is the integrated thinking concept. As a matter of fact, from an organizational point of view, connectivity implies sharing and communicating information among departments and at all level of the organization, trying to overcome the silos approach and in order to avoid the information redundancy and as a consequence, a cost increment. To clarify the concept of connectivity, it would be better for the companies to take into account these three aspects:

1. Companies should “bridge time horizons connecting past performances and future prospects”. This first factor of connectivity implies a precise analysis of what the firm has already done in the past and what it wants to

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do in the future, trying to relate the past decisions to the future firm’s conditions. From an internal point of view, it is a tough task to perform, mainly because it could bring to light some discrepancies already existing in projects or it could highlight the bad decisions made in the past. In both cases, trying to analyze and relate the past to the present implies a high level of awareness from the firms’ management.

2. Companies should provide an “effective connection between qualitative and quantitative information”. This second aspect of connectivity is the most challenging one to face with, because of the need for the organizations to combine financial information (“quantitative”) with social and environmental one (“qualitative”). The complex part consists in evaluating the quantitative and qualitative performance, due to different performance indicators that have to be adopted. If on one hand managers have to assess the financial information with economic ratios, on the others they have to develop some Key Performance Indicators through which the non financial performances can be judged. Connecting these two pieces of information requires time, complete comprehension of the ratios and KPI used, ability of exposing only relevant data.

3. Companies should “connect users...responding to stakeholders’ needs, interests or expectations”. The last aspect of connectivity reflects the firm’s capacity to disclose important information to its key stakeholders. As a consequence, the organization has to be receptive of which requirements these relevant stakeholders ask for. In this case, the issue is related to the diversity of stakeholders with whom the firm has to deal with, and the perception of which are the really important ones to take into account.

Stakeholder Relationship

Another important Guiding Principle focuses the attention on what stakeholders need. Even if the stakeholders relevance has been introduced with the Triple Bottom Line approach of Elkington, and it has been developed with the Sustainability Report successively, this IR Principle has improved the stakeholder perspective in a new way. According to the IIIRC guidelines, all stakeholders have to be taken into account, in the sense that the firm has to value all its stakeholders in the same way, avoiding to prefer one with respect to another. However, for the purpose of information disclosure, the
company has to be aware of which are the stakeholders who are “fundamental in the value creation process”\textsuperscript{53}, in order to capture their requirements and provide an efficient and complete Integrated Report. There are several types of stakeholder, with their relative needs; they could be grouped into five large categories\textsuperscript{54}: 

![Figure 1- Stakeholders’ Categories](image)

The first category consists of stakeholders who generate revenues for the organizations: the customers. The customers evaluate the products or the services delivered by the organizations; as a consequence their value proposition is based on the quality, the design, the functionality and the price of the products, taking into account also the buying experience and the customer service. For these reasons, the information required by this first group of stakeholders would be related to the inputs quality for example, or to the manufacturing processes adopted by the firm, or to the impact that the products could have on their wealth/ environment.

The second group of stakeholders is composed by people who lives the firm from an internal point of view: the employees. The employees ask the firm: “job security, good fixed pay and benefits, perhaps performance-based incentives and good carrier opportunities”. It is possible to state that in general, employees aim at being satisfied of their professional role, they want to be proud of their job in order to be continuously motivated. As a consequence, to be satisfied of their tasks, they have to be aware of what the firm is asking them to do, and they should feel comfortable with all the competencies needed to perform the job at their best. For this reason, the communication between the firm and its employees is a relevant issue to deal with.


\textsuperscript{54} Anthony R., Govindarajan V. (2003), “Management Control System”, p. 80
organization has to provide data about its main values, in order to increase the employees commitment to organizational culture; or it could describe its future objectives, in order to involve employees in the future strategy, motivating them; or at least, it could provide information about how it wants to improve the employees’ skills, in order to retain their best employees and to allow people to be continuously aligned with the external labour market.

The third category is essential to the firm’s activities: the suppliers. This group of stakeholder provides raw materials or services, for which it is rewarded by the firm. According to this perspective, it is in the best interest of the firm to satisfy its suppliers’ demand. In fact, suppliers would want to know whether their provisions are used properly by the organization, or whether the firm is able to cover its expenses. For these reasons, companies have to disclose information to ensure their willingness to respect the agreements already signed with their suppliers.

Another important group is composed by the lenders. These stakeholders can be both private people or public institutions. The lenders are capital providers, so figures who have perceived the firm’s ability to create value and for this reason, they decided to invest in it. As a consequence, the lenders want to be paid for their investment decision, and they need the firm to be solvent. Therefore, organizations have to provide data not only about their ability to generate future profits, in order to attract potential investors, but also they have to disclose their liquidity situation in order to describe their solvency capability.

The last stakeholders’ group is probably the largest one: the society. The relationship between firms and society is really complex, there are several dimensions that both parties could take into account. The society requires the firms to act according to the law, being accountable with respect to both their employees and their customers. At the same time, firms ask the society to be responsible of the external market, supporting the rules and social welfare development, the education improvement and the infrastructure provision. Society needs firms and vice-versa, and as a consequence, both parties have to work hard and be committed to reach common goals; in this scenario, firms have to provide information in order to ensure its commitment to society.

Therefore, this Guideline Principle is relevant to “enhances transparency and accountability, which are essential in building trust and resilience, by disclosing how
key stakeholders’ legitimate needs and interests are understood, taken into account and responded to.\footnote{IIRC website (2013), “Integrated Reporting <IR>”, p.18, http://integratedreporting.org/resource/international-ir-framework/}

**Materiality and Conciseness**

The “Materiality” principle is going to be analyzed in detail in the second chapter, as a consequence, in order to avoid redundancies, this part is going to deal only with “Conciseness”. As already stated in the definition of Integrated Report, the conciseness is an important principle for the IIRC. In the Guiding Principles description, the international coalition has explained how the organizations could achieve a concise formulation for their IR, underlining several aspects:\footnote{IIRC website (2013), “Integrated Reporting <IR>”, p.21, http://integratedreporting.org/resource/international-ir-framework/}

1. The firm should respect the “materiality determination process” at first;
2. The information repetition should be avoided at any time, for this reason “internal cross-references” are highly suggested;
3. The firm should provide “information that does not change frequently” in a separate part;
4. The firms should adopt a “plain language” to express the relevant data in “as few words as possible”.

In general terms, the Report should be as short as possible, maintaining a the same time, a balance between this principle and the “comparability and completeness” of information. As it was already mentioned in the sections above, the Integrated Report process is evolving, for this reason, so far, the Reports provided by the organizations which decide to prepare it, were quite long; an example is provided in the last chapter of this work.

**Reliability and Completeness**

A Guiding Principle which is extremely important for the external market is “Reliability and Completeness”. The definition provided by IIRC is the following one: “An integrated Report should include all material matters, both positive and negative, in a balanced way and without material error”. However, it would be better to analyze the two concepts separately, in order to develop their contents in the proper way. First of all, an evaluation of the milestones that constitutes the Reliability concept should be run. In the international framework, there are specified several “mechanisms” that “enhance the faithful representation” of the company, in particular the internal control
exercised by the company itself and the independent assurance provided by external firms. Taking into account the internal control through which the organization ensures that all the activities are performed according to both internal codes and policies and external law and regulations, three main types of it can be described: the action control, the personnel control and the cultural control\textsuperscript{57}.

The action control is the most direct form of control which the company can impose internally, and it consists of four different types of behaviours that employees are forced to respect:

1. \textit{“Behavioural constraints”}, companies force the employees to deal with identification card, limit access to sensitive information and in general, \textit{“separation of duties”}, meaning that a complex task is performed by many people in order to avoid gaming issues.
2. \textit{“Preaction reviews”}, which consist of controlling the plan of actions before they would be given to the employees.
3. \textit{“Action accountability”}, according to which employees are held accountable for their undertaken actions. To develop this form of internal control, the company has to communicate clearly which are both the desirable actions and the internal policies to its employees, in order to ensure that all internal people can effectively be responsible for the behaviour.
4. \textit{“Redundancy”}, the company could decide that a specific task should be run by more than one person, trying to exercise the mutual control between workers.

The action control is a preventive form of control, because its aim is to avoid that damaging actions would be performed by employees.

The personnel and the cultural forms of control are softer than the previous one, because they try to achieve the awareness of employees through their individual behaviour. The personnel control implies the company to work hard with respect to its employees, focusing its attention to them. On one hand, the company exercises the personnel control by selecting the most suitable applicants for a specific job, by supporting the employees’ skills development through training courses and by providing its employees with a proper work environment and resources to use. On the

\textsuperscript{57} Merchant A.K., Van Der Stede A.W. (2012), \textit{“Management control system, Performance Measurement, Evaluation and Incentives”}, pp. 81-95, Prentice-Hall
other hand, the firm tries to establish a better relationship with its employees through the creation of an internal organizational culture, based on shared norms and values.

The forms of control described so far are necessary to ensure the employees’ behaviour so, the non-financial performances, but another source of internal control is provided by the firm, in order to guarantee that all financial activities are run properly. In this context, a relevant role is given to the professional figure of the internal auditors. The internal auditors “must attest to and report on management’s internal control assessment”\(^\text{58}\); they are held accountable for assuring the “firm’s financial statements”\(^\text{59}\). For this reason, the internal auditors are extremely relevant for external investors, who trust the information disclosure provided by these internal professionals. The last form of control is external to the organization, and it is guaranteed by audit firms. In this case, the external assurance is provided mainly on financial reporting activities, to enhance the capital providers to be fully aware of the firms’ economic conditions, fostering the credibility of the capital market as a whole.

The Reliability of information is not enough during the preparation of the IR; in fact the firm has to provide trustable and complete information, therefore the Completeness concept is needed. An antecedent of the Integrated Report, the Sustainability Report, had already introduced several ideas related to the completeness of information. The GRI G4 had stated about the Sustainability Report: “The report should include coverage of material Aspects and their Boundaries, sufficient to reflect significant economic, environmental and social impacts, and to enable stakeholders to assess the organization’s performance in the reporting period”\(^\text{60}\). Moreover, the SR had under-lighted also the “balance” and the “accuracy” concepts, which respectively had emphasized the need to disclose data without bias and in the most detailed possible format, in order to create a truthful and specific picture of organizations’ activities. The same principles are adopted later by the IR, which has improved the already explained guidelines, by introducing the fact that the firm’s information disclosure should be related to the type of industry to which the organization belongs to. The best way to explain this concept is through the statement provided by the IIRC: “the consideration is given to what organizations in the same industry are reporting on because certain matters within an industry are likely to be material to all organizations in that

\(^{58}\) Sarbanes-Oxley Act (2002), “Key provisions”, Section 404


\(^{60}\) GRI (2015), “G4, Sustainability Reporting Guidelines”, p.17, GRI website
industry\textsuperscript{61}”. Therefore the preparation of the Integrated Report implies the firms to disclose trustable and complete information.

\textit{Consistency an Comparability}

“\textit{Consistency and Comparability}” compose the last Guiding Principle of Integrated Report. In this case, the concepts have been developed to protect the capital providers; as a matter of fact, the firms are forced to provide information in such a way that allows both existing and potential investors to have a complete picture of how several firms are operating, in order to make the best informed decision. As a consequence, organizations are incentivised to disclose their data “\textit{on a basis that is consistent over time}”, which means “\textit{reporting the same KPIs if they continue to be material across reporting periods}\textsuperscript{62}”. The data published by the firms should be not only consistent over time but also comparable across companies. The comparability of information can be considered as a challenge during the preparation of the Integrated Report, due to the qualitative nature of social and environmental information. For this reason, nowadays, the level of comparability of the IR is still too low with respect to the level provided by the traditional financial report. In fact, the financial statements disclosed by the organizations are easily comparable both over time and across companies, because the relevant economic data required by the external market are always the same, no matters the time period considered or the firm’s type\textsuperscript{63}. In order to enhance the level of information comparability, the IIRC has presented three tools that the organizations could use during the IR preparations: companies could look at “\textit{benchmark data}” or they could disclose data “\textit{in the form of ratios}” or they could focus on “\textit{quantitative indicators commonly used by other organizations with similar activities}”.

All the Guiding Principles described so far are essential to prepare the Integrated Report, mainly because they aim at ensuring an alignment among all the companies.

\textbf{1.5.2 Content Elements}

In the following section the contents, that the international coalition has suggested to write down in IR, are analyzed. To better comprehend the complete

\textsuperscript{63} Fasan M. (2013), “\textit{Integrated Reporting: Concepts and Cases that redefine Corporate Accountability\textordmasculine}”, pp.49-50, Springer
process that the firms have to disclose to the external market, it would be helpful to report the picture formulated by IIRC.

The central part of the Fig. 3 is composed by the Content Elements, which the organizations have to be aware of and provided information about. Before describing the features within the white square, the attention should be focused on the external environment, Content Element which is labelled “Organizational overview and external environment”, which basically answers the question: “what are the circumstances under which it (the firm) operates?” The conditions in which the firms are running their activities have to be specified from several perspectives: “macroeconomic factors, government regulations, competitor moves and customers demand”. In this context, firms have to consider how the economic stability/instability could affect their activities, how both the globalization and the rapid technological development could favour or damage their situations, how particular social issues should be taken into account, how some regulatory bodies could impact positively/negatively their operations, how competitors could move up/imitate their modus operandi, how stakeholders’ needs could change over time; all the previous uncertain conditions

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require the organization, and as a consequence the people who composed it, to show a high level of flexibility and adaptability to continuous transformations. Once the firm has been aware of its external environment, it could concentrate on its internal one.

From an internal point of view, the firm deals with some relevant Content Elements: “Governance”, “Risks and Opportunities”, “Business Model”, “Strategy and Resource Allocation”, “Performance” and “Future Outlook”\(^66\). The “Governance” concept has been already explained in the section 1.4, but it would be better to emphasize that one role of the corporate governance consists of dealing with the “Risks and Opportunities”. As a matter of fact, the firm’s management is responsible for the Enterprise Risk Management (ERM). “The credit crisis of 2008/2009 demonstrated that risk management was weak in many companies. As a result, financial regulators now promote ERM to help manage risks and to demonstrate that they are taking action\(^67\)”, with this introductive statement, it is possible to capture the huge relevance of the ERM nowadays; it ensures that the “strategic, operating, reporting and compliance objectives\(^68\)” are achieved. At the basis of the ERM there are eight different steps that the firms have to follow to evaluate their operations in relation to both the potential risks to face with, and the possible opportunities to seize:

![Figure 3- ERM's Components\(^69\)](image)

Therefore the firm starts by analyzing its internal processes, setting its main goals to achieve and relative risks that have to cope with; once the risk response is provided, the company would focus its attention on the controlling phase, in order to ensure that all

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activities are performed according to the initial plans. At this time, it has to provide information about how it is managing both risks and opportunities, in order to provide the external stakeholders with a truthful picture of its operations.

Moreover, to disclose such a complete picture it has to report data about its strategy and how it is willing to control the resource allocation process. The following Content Element is the “Strategy and Resource Allocation”. The strategy has been already defined in this work, so, in order to avoid redundancies, it would be better to proceed with the “resource allocation” process description. The two concepts are extremely related each other, because the firm has to organize its resource allocation plan in order to reach the ultimate strategic objectives. The resources that the companies have to manage can be different and, the easiest distinction in this context, is between tangible and intangible resources. According to the International Accounting Standards (IAS), the tangible resources, or assets, are mainly “property, plant and equipment”, which could be recognized as fixed assets when “it is probable that the future economic benefits associated with the asset will flow to the entity, and the cost of the asset can be measured reliably”\(^70\); while the intangibles “are non monetary assets, which are without physical substance”\(^71\). It is possible to state other two interesting sources that the companies could use: the innovation and the management resource; if the firm is able to exploit them at their best, it would be able to boost its ability to generate value. So, focusing on the initial assets, both tangible and intangible resources are necessary to build the firm’s value; this approach is named “Resource based view”\(^72\). According to Arbore and Valdani, “il valore generato dall’impresa è funzionale alla specificità, qualità e varietà del suo stock di risorse e competenze”. The firm will be able to create a particular competitive advantage on the basis of the resources adopted, so to protect its advantage from competitors’ movements, it has to plan the resource allocation process carefully.

The most relevant Content Element consists of the “Business Model” that the organizations have to provide to the external market. A general description of the business model has been already introduced in the previous part, however, in this section, the interest would be on the four milestones which compose the complete

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\(^72\) Arbore A., Valdani E. (2014), “Strategie e giochi competitivi, gestire il presente, immaginare il futuro”, pp. 5-8, Egea
The key stages that are going to be described are: inputs, business activities, outputs and outcomes.

“The first component of a business model coincides with inputs\textsuperscript{73}, which could be explained as “components of production (such as land, labor, or raw materials)\textsuperscript{74}”. Linking these definitions to the Fig. 3, it is possible to notice that the inputs according to IR, are composed by several resources, which are named “Capitals”. The “Capitals”, that would be exposed later, come from the external environment and they are firstly collected by the organization, and then utilized and transformed, through the manufacturing process, to generate the final value proposition. For this reason, each input is affecting the firm’s ability to produce goods and services, and as a consequence, the company has to be aware of which inputs are crucial for its business, and which information could be disclosed about them.

The second milestone at the basis of the business model consists of the “business activities”. The “business activities” run by the organizations, depend on the type of strategy that the firms themselves have decided to adopt in order to be profitable. In fact to maintain the market share, the companies have to differentiate themselves by the competitors, through “product differentiation, market segmentation, delivery channels and marketing campaigns\textsuperscript{75}”. Moreover, to maintain their market position within the industry, the firms have to show their ability to change their business activities, adapting them to the new market conditions. All the activities convert the inputs into outputs and for this reason, they are essential to the value’s creation process. Even though, the outputs, and the subsequent outcomes, have been already illustrated in the previous part, it would be better to add that the final outcomes, produced by the organizations, could be of two types: “techno-economics” and “psychological” outcomes\textsuperscript{76}. Both categories of outcomes would have a final impact on one hand on the organization itself, in fact the employees could be affected by psychological outcomes, becoming more motivated or not in pursuing the firm’s objectives; on the other hand on the external environment, so on society, which subsequently would again affect the future inputs of the firms.


\textsuperscript{74} Merriam-Webster website, “Inputs-Vocabulary”. https://www.merriam-webster.com/dictionary/input


generating a kind of circle. Therefore, the firms should disclose data about how they are willing to use their resource to produce their final outcomes.

Another Content Element which could be perceived as a component taken away from the traditional financial report, is the “Performance” evaluation. The IR includes the disclosure of the performances reached by the firms. To allow the stakeholders, especially the capital providers, to make well-informed decisions, the company should provide evaluation on its activities both from a financial point of view, and from a non-financial perspective. The indicators adopted in the economic evaluation are typical of the financial report, and they are composed by ratios subdivided into several groups:

1. Profit Ratios; they are “ratios constructed entirely from the income statement”. In this group, it is possible to identify the Gross Profit Margin ratio, the Net Profit Margin ratio, the Expenses to Sales ratio, and the Net Operating Profit ratio.
2. Profitability Ratios; they are indicators which explain how the firm assesses “the use of scarce resources that are not cost-free and that need to be used as efficiently as possible”. They are composed by the Asset Turnover ratio.
3. Ratios taken into account mainly by investors, which are Return on equity, Return on Capital Employed and Gearing ratios.

All these financial indicators are helpful both to enhance firm’s credibility and reputation, and to increase the comparability level across time and across industry. Because of the IR has required the provision of non-financial data too, the companies have been forced to find out a way to provide the social and environmental information in a numerical way as well. It was a really complex process, which is not already completed; in fact, to report non-financial information in a monetized way, the firms have to respect the following process: at first, identifying some “Critical Successful Factors”, so comprehend which activities are relevant for their business, and then, identifying the relative Key Performance Indicators, through which they can judge whether they improve and reach their targets. Concerning the numerical expression of non-financial features, a very useful example is provided by the introduction of the Environmental Profit & Loss. “An Environmental Profit & Loss account (EP&L) allows a company to measure in € value the costs and benefits it generates for the environment, and in turn make more sustainable business decisions”. The EP&L is composed by

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horizontal dimensions (“store warehouse offices, assembly, manufacturing, raw material processing, raw material production”) and vertical ones (“air pollution, Greenhouse gas emission, land use, waste, water consumption and water pollution”), which create a table where the organizations can express their impact on each element, in order to identify the areas where they have to improve their performance from an environmental point of view\(^\text{79}\). Taking into account the social data that the companies have to disclose, and considering that there is not an existing “Profit & Loss” that reflects the firms’ social efforts, the only way to prove their commitment to social issues is to describe in a detailed manner their behaviour, and to provide some relevant international certifications which attest their actions. Therefore, the majority of information would be expressed according to quantitative terms, but the features that cannot be summarized in a numerical form, would be reported in qualitative terms.

In the end, it would be better to described the last Content Element, which in reality could be perceived as the backbone of all the firm’s operations: the “Future Outlook”. The definition provided by the IIRC is the following one: “an Integrated Report should answer the questions: what challenges and uncertainties is the organization likely to encounter in pursuing its strategy, and what are the potential implications for its business model and future performance?\(^\text{80}\)”. According to this statement, the companies should disclose information taking into account two different dimensions: how the uncertainties could impact both the business model and the future performance. In order to provide data about the potential or expected changes, the firms should be aware of their current situation, and to do so, they could run the “Five Forces” framework. The framework was introduced by Porter between 1980 and 1985; his work’s aim was to “better assess the impact of the industry forces over the firm performance\(^\text{81}\)”. Porter provided the description of the five forces, which so far are:

1. *Power of suppliers*: in fact the suppliers play a relevant role in the industry, mainly due to both their “number and concentration” and the “presence of substitutes” with the relative “switching costs”. The firm should evaluate the bargaining power of its suppliers, to capture how much they could influence their business activities.

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2. *Power of buyers*; the buyers can influence the firm’s activities through their preferences and the ultimate trends; for this reason, the companies should maintain a high level of dialogue with their customers.

3. *Threat of substitutes*; the firms should focus the attention on the existing competitors in order to be able to anticipate their moves whether necessary, and to know which would be the future trends.

4. *Threat of new entrants*; this risk is related to “the presence of barriers to entry” in an industry. In fact, if an industry shows high barriers to entry it means that, from the operating firms’ perspective, they are protected from a high level of competition and so their profit margin could be quite constant, while from the external firms’ point of view, it would be very hard to penetrate that industry that seems to be really attractive.

5. *Intensity of rivalry*; there exist “four major elements that influence this (the rivalry): industry growth, concentration, cost structure and product differentiation”. In this context, the firms should know exactly which are the characteristics of the industry in which they are operating.

Therefore, each company has the opportunity to comprehend the factors\(^{82}\) that could have an impact on their businesses, and on the same time, they could align their strategy to the future expected scenarios.

Both the Guiding Principles and the Content Elements have been described in order to allow the reader to comprehend that the IR requires a huge amount of data, both financial and non-financial, and it imposes several principles to follow during the preparation. As a consequence, the principles and the contents required are, in some way, tough issues to be managed by the companies, mainly because the firms themselves have to conduct costly and time-consuming actions to draw up a final Integrated Report paper.

### 1.5.3 The Capitals

The Guiding Principles and the Content Elements are supporting the companies in preparing the IR; however, some relevant components would be analyzed in the following section: the types of inputs used by the organizations. As already introduced in the part of the Content Elements, according to the Integrated Report guidelines, the inputs are named “*Capitals*”, and the IIRC has identified “*Six Capitals*” which the firms

\(^{82}\) Buzzavolo L. (2012), “Strategy in three dimensions, perspective for strategy innovation”, pp.64-73, CEDAM
mainly adopted, and which are provided by the external market. It would be better to analyze the capitals on the basis of their typologies, grouping together capitals that could be perceived as similar. All the capitals are represented in a valid picture, provided by the IIRC in its document.

Figure 4- Six Capitals

The first two capitals are strictly related to the firms’ need of being able to produce goods and services, as a consequence, to fulfil the production process’s requirements the “Financial” capital and the “Manufactured” capital are essential. “Financial capital is broadly understood as the pool of funds available to an organization”, therefore all the financial resources provided by external stakeholders, both debt holders and equity holders, compose the financial capital. The financial input could become effective when it is transformed in other sources of “Capital”. On the other hand there exists the “Manufactured” capital, which consists of all those tangible tools required to run the production activities. In this context, an easy distinction should be made between manufactured capital “owned, leased or controlled” by the organizations; in fact the firms can own or lease or simply control physical objects such as “equipment, tools, plant, buildings or infrastructures”.

Other types of capitals are the “Intellectual” capital and the “Human” one. The intellectual capital serves two main purposes within the organizations: supporting the existing firm’s operations, developing new competitive advantage and orienting the firms in their future potential source of revenues. Providing a comprehensive definition

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of what intellectual capital is, could be simplistic, for this reason it would be more
helpful to describe the components of the intellectual input.

First of all, the organizational intellectual capital is composed by knowledge. According to Pearlson and Saunders, all the firms are characterized by the “Taxonomy of knowledge\(^{86}\)”, which could be described as the knowledge at three different levels: the firm should be aware of the “know-what”, so how the information could be assembled, as a consequence, they should know how to classify the data; the companies should develop the “know-how”, so acquiring specific skills to perform a complete set of actions. The last level of knowledge that organizations should possess is the most important one, “know-why”; in fact it allows firms to be completely aligned with their current strategy and with their future targets.

The second component of the intellectual capital is the intellectual property. This component of the intellectual capital is strongly protected against competitors and against the possible usage of the external market thanks to the “legal rights”, which the companies have on “patents, copyrights, software and licenses\(^{87}\)”. To develop such an intellectual property the firms would invest in the Research & Development activities.

As regards the “Human” capital, the EY’s document about the six capitals describes it as: “people’s competencies, capabilities and experience, and their motivations to innovate”. Therefore, the human capital’s focus consists of people. Employees should be perceived by the organizations as a primary source of advantage, they can enhance the firms’ growth through their personal skills. Within an organization, people can acquire competencies in two ways: due to the “tacit knowledge” or to the “explicit knowledge”\(^{88}\). The first one requires the person to comprehend new concepts through the direct experience, so through the observation and the practice; this form could be synthesized as “learning by doing”. The second form of knowledge is based on written rules and policies; all the processes are composed by several steps which are clearly expressed in words, so employees can easily read and study them. So, it is in the best interest of the companies both to support the employees’ training and to push their personal motivation, protecting their job environment from an


economic point of view (through fair compensation policies) and from a social perspective (through equal opportunities’ protection).

Strictly related to the intellectual and human capitals there is the “Social and Relationship” input. According to the IIRC, this capital is explained as “relationships within an organization, as well as those between an organization and its external stakeholders, depending on where social boundaries are drawn”. In the part of the Guiding Principles, both the relationship between the organization and its stakeholders, and the relationship between organization and society have been already explored, for this reason the only thing that it would be better to emphasize is that at the basis of this capital there exists the communication among parts.

In the “Human” capital and in the “Social and Relationship” capital, two different perceptions\(^{89}\) could be identified: a “focus on stakeholder” and a “focus on capital itself”. The first approach implying that both of the two capitals reflect the characteristics of specific stakeholders’ groups, such as employees or customers; while in the second approach the capital as a whole is perceived as able to generate value, without making distinctions between stakeholders involved.

The last capital is the “Natural” one. The OECD organization has provided a meaningful statement to identify the natural capital approach: “The Natural Capital Approach (NCA) applies the concept of capital to the natural environment, conceiving of the natural environment as the basis for all human activity, including economically productive activity\(^{90}\)”; according to this definition, the natural resources are the primary inputs for the majority of activities; however to assess how much relevant is the natural capital for the firms, each single organization should be aware of which could be the “current flow of income” and the “potential future flow of income” generated by the usage of natural resources. As a matter of fact, the companies have to relate the natural capital to the financial performance to understand whether the natural resources can be adopted to create value, both in the short term perspective, and in the long term one, being aware that the long term growth will be possible through “renewable resources”. To identify all the capitals clearly, it is necessary to determine some measurable features, just defined as KPIs: “Each capital has a number of KPIs associated with it,

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which together enable...to deliver an integrated view of performance, inside and outside the organization\textsuperscript{91}, some examples would be provided in the following table:

<table>
<thead>
<tr>
<th>Capitals</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial</td>
<td>Assets, debts, equity</td>
</tr>
<tr>
<td>Manufactured</td>
<td>Buildings, equipment, infrastructure, supplier audits, product recall</td>
</tr>
<tr>
<td>Intellectual</td>
<td>Patents, culture, brand reputation, copyrights, protocols</td>
</tr>
<tr>
<td>Human</td>
<td>Employees, cor. governance, gender in management, health and safety</td>
</tr>
<tr>
<td>Social &amp; Relationship</td>
<td>Donations, animal purchased for R&amp;D, common values</td>
</tr>
<tr>
<td>Natural</td>
<td>Energy, water, air, waste, biodiversity, eco-system health, minerals</td>
</tr>
</tbody>
</table>

Table 2- Items of each Capital\textsuperscript{92}

In the initial Fig. 5 it is possible to notice how the international coalition believes that the capitals are prioritized according to the companies. The reason why the capitals are distributed in this way lies on the fact that all organizations need financial and manufactured capitals to produce goods and services; at a second stage the firms use intellectual, human and social & relationship capitals to support the production processes and to differentiate themselves through competitive advantage; in the end they consider the natural capital, believing that they are not using it, even if the natural input is at the basis of all firms’ activities. Moreover, the most important issue does not consist of explaining only each single capital, but \textquotedblleft research on multiple capitals is expected to explore how companies...report the \textquotedblright interdependencies\textquotedblright and potential trade-offs between multiple capitals\textsuperscript{93}, for this reason all the capitals are correlated to each others, and the relative interrelationships\textsuperscript{94} could be summarized as follow:

1. \textit{Financial Capital}, it allows the company to finance all the activities needed to exist, so it is at basis of the other capitals’ exploitation.

2. \textit{ Manufactured Capital}, it is related to:

\textsuperscript{91} Fasan M., Mio C., Pauluzzo R. (2016), \textquotedblleft Internal application of IR principles: Generali's Internal Integrated Reporting\textquotedblright, p. 213, Journal of Cleaner Production

\textsuperscript{92} Demartini C., Trucco S. (2017), \textit{An empirical analysis in the European setting}, Integrated Reporting and Audit Quality, Chapter 2, p.19, Springer


\textsuperscript{94} IIRC website (2013), \textquotedblleft Capitals background paper for <IR>\textquotedblright, pp. 6-12, https://integratedreporting.org/wp-content/uploads/2013/03/IR-Background-Paper-Capitals.pdf
i. Financial capital, because it affects the financial situation of the organizations, and as a consequence, possessing manufactured capital could require the organizations to increase their level of financial capital;

ii. Intellectual capital, because the manufactured capital could embody the research & development results of the company (for example, “equipment manufactured using patented technology”).

3. **Intellectual Capital**, it could affect the:
   i. Financial capital, because the intellectual property of “goodwill” affects the financial statements from an accounting point of view;
   ii. Human and Social & Relationship, because to develop the intellectual results, the organizations need both the two capitals, so they are “complementary”.

4. **Human Capital**, it is related to:
   i. Financial capital, because the motivation of employees could lead to both extremely positive or extremely negative results in economic terms;
   ii. Social & Relationship, because the organizational human capital should be aware that the firms could operate in any industry thanks to the conditions favoured by the regulatory bodies and by the legal jurisdictions; moreover, the educational level of organizational human capital strictly depends on the opportunities given by the society: the capitals are “clearly linked in a kind of virtuous circle, with education tending to increase social capital and at the same time social capital tending to increase educational performance.”
   iii. Intellectual capital, as already stated, they are “complementary”.

5. **Social & Relationship Capital**, it has a strong interrelationship with the Intellectual capital and the Human one, as already mentioned above.

6. **Natural Capital**, it is related to:
   i. Manufactured capital, because without natural resources, the production activities cannot be run;
ii. Intellectual capital, because some phases of research &
development process cannot be completed without specific
natural sources,

iii. Social & Relationship capital, because exploiting the natural
environment has a strong impact mainly on the stakeholders
external to the firm, such as on communities located near the
plants.

Once the capitals and their relative correlations have been identified, it would be better
to focus the attention on some issues\(^95\) that could arise during the description of the
capital used. First of all, the “measurement” of capitals could be subject to a distinction:
the inputs adopted by the organization and their relative impact on the outputs could be
evaluated both in quantitative terms, through the KPIs, and in qualitative terms, through
a narrative form of presentation. For this reason, the firm’s management should be able
to provide information according to these two types of presentations, keeping constant
all the Guiding Principles expressed above, particularly, the conciseness and the
completeness. Another issue that could cause problems is the “ownership of the
capitals”; in fact, some capitals could not be owned by the companies, because they
could be possessed by other entities, and some specific resources, mainly the natural
ones, cannot be owned at all by the organization, which has only the opportunity to
exploit it, such as the firm could have the “access to unpolluted air or water”.

Therefore, companies have to consider as inputs also the capitals that they do not posses
directly, simply because they are using them. Then, the organizations should deal not
only with the capitals adopted as initial resources, but also with the final effect that they
produce at the end of the activities, so the outcome on capitals. Using capitals means
that firms are influencing their “availability, quality and affordability”. As a matter of
fact, not all resources are renewable, there are some specific ones which are in “limited
supply and non-renewable” and which require a strong protection by the possible over
exploitation. This particular protection behaviour is needed to ensure the maintenance of
scarce resources in a long term perspective.

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\(^95\) IIRC website (2013), “Capitals background paper for <IR>”, p.4, https://integratedreporting.org/wp-
content/uploads/2013/03/IR-Background-Paper-Capitals.pdf
1.5.4 Value Creation Process

As a matter of fact, at the basis of IR, there is the value creation process concept. Before explaining which is the value emphasized by the IR, it would be better to define what value is: “the notion “value” in general stands for the appreciation of the benefit(s) that a person (or a group of persons) perceives to gain from an issue or object”\(^{96}\). So, the value generated by the companies could be a relative perception, because it depends on the audience to which the “benefits” are addressed to. According to this vision, there exist three main typologies of value creation process, identified by Haller A. in the book “Integrated Reporting, A New Accounting Disclosure”. The first notion of value creation process is strictly related to the economic perspective of value: “in economic valuation only benefits that can be expressed in monetary terms are usually considered”; for this reason, the most important group of people who could gain monetary benefits from the organizational activities are the capital providers, so this particular type of value is named “Shareholder’s value”. Shareholders are the most interested group in the economic value creation, because they want to compare the financial remuneration that could be provided by several companies, in order to invest in the best one, which would give them the highest economic return.

The capital providers are not the only group which could both benefit and be impacted by the organizational operations; as a matter of fact, other groups of people are involved with the company: the stakeholders. The “Stakeholder’s value” reflects the ability of the firm to create both “tangible value” and “intangible one”, on the basis of the processes adopted. In fact, on one hand, the “tangible values” are created through the organizational manufacturing activities, which provide the stakeholders with tangible goods and services; while, on the other hand, some “intangible values” are generated by intangible skills, such as the experience and the know-how internal to the firm. In this case, the “intangible values...cannot be monetized”\(^{97}\).

A third category presents some relationships with the company: the society. According to the society’s needs, the value generated is defined “Public value” and it could be perceived not only as a “tangible” or “intangible” value but also as a “ethical” one. In fact, the organizations could embody some particular ideas, cultures and behaviours, generating a specific moral atmosphere around them. Therefore, from the


society’s point of view, the organization is accountable for several types of value propositions.

Therefore, three main types of value exist, and according to the <IR> framework, the value is described as: “value created by an organization over time manifests itself in increases, decreases or transformations of the capitals caused by the organization’s business activities and outputs”. The utilization of the capitals to generate final outcomes has been already analyzed in the previous section, so, it would be better to focus on the audience to which the value is addressed according to the IR: to “the organization itself”, so to those people who had finance the company, and to “others”, so to both stakeholders and society as a whole. More precisely, it is possible to identify four dimensions through which the firms could generate value, according to Bartolini, Santini and Silvi. The authors have represented their idea in the following picture, describing the scheme as “Integrated performance Measurement System”.

Figure 5- Integrated Performance Measurement System

The Fig. 6 represents the four perspectives that the organizations have to take into account when they have to evaluate their ability to generate value; moreover, “each dimension can be observed and managed through a triple perspective: economic, environmental and social”.

The first point of view to consider is the “Value chain” as a whole; the companies have to analyze which capitals would be used to support the activities and which is the role played by the suppliers in this context, how the business model is affected by the utilization of these capitals, what they are able to generate and how the customers perceive the value proposition received. Secondly, the organizations have to concentrate on their “Internal processes”, meaning that they would pursue two relevant goals: the “efficiency” and the “content” of each activity. For this reason, all the

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elements related to these aspects would be taken into account, from the level of productivity to the support of technology, from the CSFs to the identification of the Key Performance Indicators. Another perspective considered is the “Innovation & Knowledge”. In this scenario, “element such as foresight (anticipating the market or the competition) become more important than positioning (adopting the optimal position given the current circumstances)”\(^\text{100}\); so the organizations should be aware of the future market’s opportunities in order to seize them and to support their value chain not only through the internal learning process, but also through the innovation process. The last dimension to be analyzed consists of the “Competitors & best practices”, which would enhance the comparability level of value produced. In fact, companies are not operating alone, they are integrated in an industry with multiple competitors to face with, so, if on one hand, the drawback is given by the high level of competition to monitor, on the other hand, a benefit is produced: firms have the opportunity to compare their outcomes with others, looking at the benchmark companies and promoting the so called “best practices”.

Therefore, the value produced by the companies cannot be perceived as unique, it shows several features and the audience for which it is produced is heterogeneous too, as it is reported in another academic paper, where it is stated: “CSV (Shared Value Creation) is conceptualized as a strategic approach that focuses on identifying and expanding the connections between societal and economic progress by addressing social issues that interconnect with the business...CSV strategies call for long-term investments driving sustainable competitiveness by consistently addressing social and environmental goals”\(^\text{101}\), implying that the value creation process is based on the management of the relationship between “social and economic” issues, in which the organizations have to invest to reach both short term goals and long term ones.

1.6 Critiques and issues related to IR

So far the Integrate Reporting process has been explained in details, emphasizing which is the role of IIRC in developing its framework and how the companies are expected to act in order to fulfil this new accounting process. However, the IR

\(^{100}\) Buzzav L. (2012), “Strategy in three dimensions, perspective for strategy innovation”, p.125, CEDAM

implementation has posed several issues both from a theoretical point of view and from a practical perspective.

From a theoretical point of view, the IR should push the companies in disclosing both financial and non-financial information in order to allow all the stakeholders to make more informed decisions. From this concept, the figure and the relative role of the stakeholders should be strongly emphasized, but in reality, the IR aims at improving the quality of the disclosed information mainly for the shareholders. As a matter of fact, one of the main goal of the IR report is to allow the companies to provide the ESG information in a quantitative way, rather than to support its narrative nature. As Brown and Dillard wrote in their paper, “It (IR) provides a way of making sustainability impacts “financially visible””, and moreover they added “The proposals (of IIRC) exhibit a strong investor bias, with no attempt to open up substantive discussion on important – and contentious – issues around corporate accountability or sustainability."\textsuperscript{102}”, for this reason, the capital providers’ role is remaining crucial, while the needs of all the other stakeholders are shifted into the background. The same idea is described also by De Villiers, who has stated: “Integrated Reporting now seeks to present information related to broad risk evaluation and potential future value growth thus appealing to capital providers and potential investors\textsuperscript{103}”. However, another author has highlighted that “Integrated Reporting’s implied pathway to ‘sustainability’ is that, if profitable (‘value-creating’) corporations, investors’ wealth and capitalism are sustained through better risk management, then beneficial social transformations will follow. This is an extension of the much critiqued ‘trickle down’ theory, where any benefits accruing to a large corporation will eventually pass down to smaller businesses and consumers \textsuperscript{104}”, implying that, at first the benefits should involve the large companies and in a second moment, they could be extended to the society as a whole.

From the above stated sentences, another critique is appearing other than the audience’s role. The firm’s accountability for sustainable issues seems not to be strongly relevant by itself, in the sense that it is not in the primary interest of the firm to focus on a sustainable development of activities for their own: “Firms with weak social

\textsuperscript{102} Brown J., Dillard J. (2014), “Integrated reporting: On the need for broadening out and opening up \textsuperscript{103}”, pp. 15-16, Accounting, Auditing & Accountability Journal
\textsuperscript{104} Thomson I. (2014), “‘But does sustainability need capitalism or an integrated report’ a commentary on ‘The International Integrated Reporting Council: A story of failure’ by Flower, J.”, p.20, Critical Perspectives on Accounting
and environmental record use IR disclosure to detract attention from these results. These findings strengthen the idea of the use of the IR as a mean to opportunistically manage public impression\(^{105}\). As support of this idea, Fasan and Mio have provided some interested results related to a study conducted on a group of Italian firms which have adopted the IR; the findings suggest that the large part of companies have adopted the IR “due to pressure from society”, and to boost their “internal and external growth opportunity”\(^{106}\), meaning that on one hand the companies are not disclosing social and environmental information because they want to, but because they are forced to, and on the other hand, they are trying to exploit the new reporting process to create an advantage for themselves at first, and not for the whole society.

From a practical point of view, the preparation of the Integrated Report has appeared to be a challenging process. The whole process, from gathering information to publishing the final report, “took more than a year to be completed”, implying that the costs related to the preparation could be quite high for each organization. So, the companies have to run “cost/benefit analysis”\(^{107}\) in order to be sure that providing the report could not be economically damaging. Furthermore, the IIRC has presented the IR as an “organization’s primary report”, with the aim of creating a comprehensive document including all the relevant information, but “there is no obligation to present a single integrated report” as suggested by Flower in his paper\(^{108}\), with the consequence that the organizations put their efforts in providing the mandatory reports at first.

Moreover, the amount of information to be disclosed (the six capitals and the relative trade-offs) is quite large, and the Guiding Principles to be followed are extremely demanding to be fulfilled; as a consequence, the firms should be able to face both the issues during the preparation process. In this context, according to Fasan and Mio, the “challenge faced by companies was related to the lack of specific competences and knowledge and to the difficulties in following a principle-based framework. Also, the process of obtaining disseminated information was problematic.”\(^{109}\). Furthermore, assuming that the management has the required skills to prepare the IR, it is necessary to ensure the society that the data provided are consistent and reliable, so the two main

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issues that the organizations have to cope with are the materiality and the assurance of information. For the financial information both of the features are guaranteed, in fact on one hand the materiality is fulfilled by the legal requirement, while on the other hand, the assurance is given by both the internal and the external auditors. Regards the pre-financial data, the two issues are really tough to manage. As a matter of fact, there are not international standards recognized from legal point of view (except for Directive 2014/95/EU) which drive the companies in disclosing all the same data, so each organization can actually disclose the information that it considers to be more useful or powerful; at the same time, the data cannot be fully guaranteed because the external audit firms are not yet able to properly evaluate them. Both the materiality and the assurance of non-financial information would be analyzed in the next chapters. So in general, even if at the basis of the IR still exist the needs of the capital providers at first, the Report could “secure capital and credit, help win the war for talent, and build strong business relationships\textsuperscript{110}”, bringing to the organizations several benefits such as “increased investor confidence, increased supply chain confidence, image improvement, better internal strategy and communication and motivation to improve integrated thinking\textsuperscript{111}”; but due to its early stage, adopting the IR implies that the companies have only to face challenges without benefiting from its usage. All the features just analyzed have been defined “failures” by Flower, who has exposed his thesis stating that the IR was created on stretch objectives, which at the end IIRC have not succeed to reach. According to the author, the reason why of this “failure” consists in the result of a “division in the IIRC’s organization between the idealists (the advocates of social and environmental accounting) and the realists (representatives of the accountancy profession, preparers (notably multinational enterprises) and regulators)\textsuperscript{112}”, because on one hand the Integrated Report was born by the ideological concept of making the firms more accountable from several perspectives, but on the other hand, the regulatory bodies have aimed at drawing up a document which would be approved by the existing capital providers and by the potential investors (“IIRC is business and investor friendly and is not proposing anything that these parties would find unacceptable”); the same concept is supported by Adams, who stated “changes in disclosure patterns are


governed by a concern with profit maximisation”. However, Adams has explained also that “it is certainly much too early to assess its (of IR) success or failure”, and that the “idealists” have been necessary to the early development of this new reporting process, which should be supported due to “the necessity of getting senior executives and Board members to think (long term) about their business model, how they create value and to whom, material issues, risks and strategy together which gives integrated reporting the potential to effect change”\(^{113}\); in a similar way, to support the IR’s development, Thomson has stated: “It is impossible to predict with certainty the future impact of Integrated Reporting...Reporting appears to be a well-intentioned initiative that reflects a pragmatic desire to do something and I hope it does fulfil some of its potential”\(^{114}\), meaning that the IIRC’s framework could bring both the corporations and the society many advantages, which have not yet been developed so far, due to its early adoption.


\(^{114}\) Thomson I. (2014), “‘But does sustainability need capitalism or an integrated report’ a commentary on ‘The International Integrated Reporting Council: A story of failure’ by Flower, J.”, p.21, Critical Perspectives on Accounting
2 Materiality

2.1 Financial and non-financial information materiality

Once the IR’s structure has been described in the first chapter, in the second one, the attention is going to be focused on the first existing issue strictly related to the Integrated Reporting process: the materiality of disclosed information. In the first section of this part, the materiality issue is analyzed both for the financial information and for the pre-financial data that organizations have to provide.

2.1.1 Financial information materiality

In the Integrated Report the financial data should be published in order to allow the existing capital providers and the potential investors to make more informed decisions; as a matter of fact, the information provided must be true, reliable and useful otherwise the risk of misdirecting shareholders is going to be real. All the previous characteristics that the data should have, can be summarized in an unique definition: the information should be “material”. The complete meaning, from a financial perspective, associated to the term materiality is provided by a document approved by the International Accounting Standard Board (IASB), which has recently stated: “To be useful, financial information must not only be relevant, it must also represent faithfully the phenomena it purports to represent. Faithful representation mean representation of the substance of an economic phenomenon instead of representation of its legal form only. A faithful representation seeks to maximize the underlying characteristic of completeness, neutrality and freedom from error.” The statement is associating to the financial information materiality with three main characteristics emphasized: “completeness”, “neutrality” and “freedom from error”, implying that the data must be as much complete as possible, represented through a “prudent” view (the conditions of uncertainty should generate a caution approach in evaluating and disclosing data) and represented truthfully without misleading numbers. Moreover, the Framework is underlying also the features of “comparability, verifiability, timeliness and understandability”, which have been already explained in the first chapter.

In order to guarantee that all the pieces of information respect these characteristics, the firms incur in high disclosure costs, but this consequence does not

affect the process; in fact, in the same Framework, IASB has reported: “reporting such information imposes costs and those costs should be justified by the benefits of reporting that information”\(^{(116)}\), for this reason, even if there could be a high level of expenditure to face with, the benefits would repay the organization’s efforts. Moreover, it would be better to remind that the majority of financial data are subject to mandatory disclosure, for this reason, both regulatory bodies and legal jurisdictions ask the firms to be accountable for such a type of data, and, as a consequence, “the cost related to the mandatory disclosure are unavoidable”\(^{(117)}\). So, the materiality principle from an economic point of view is composed by the above mentioned features, while its scope can be captured by the following comment provided by Fasan and Mio to the IASB’s Framework: “the omission or misstatement of items is material if it could influence the judgement of the reports user’s”\(^{(118)}\). According to the statement, the financial data are necessary for the users of the report, emphasizing the so called “user utility approach”, which poses, at the centre of the materiality concept, the user’s needs of making economic decisions. In a similar perspective, Unerman and Zappettini have stated in their comment: “clarity of corporate reports, and their communicative effectiveness, can be diminished where information that is not material is included in the report”\(^{(119)}\), meaning that the corporate report could lose its utility if the immaterial data are disclosed at the same level of material ones.

### 2.1.2 Non financial information materiality

“Materiality is now a key reporting principle, not only for the financial impact of the organization’s activities, but also for their social and environmental effects”\(^{(120)}\), in this way thanks to the paper of Barnabè et al., it is possible to introduce the analysis that would be run in this part. In the first chapter it has been exposed the increasing relevance of voluntary non financial information disclosure, data on which the Integrated Report is mainly based.


\(^{(119)}\) Unerman J. Zappettini F. (2014), “Incorporating Materiality Considerations into Analyses of Absence from Sustainability Reporting”, p. 175, Social and Environmental Accountability Journal

Before moving to the definition of what materiality is in the case of pre-financial data, it would be better to focus on the voluntary disclosure issue for a while. If in the case of mandatory disclosure, the financial information must be provided by the organizations, otherwise they will be considered liable from a legal perspective, in the case of voluntary disclosure, the firms are not obliged to disclose their data, so reporting non-financial information to a public audience would be only a firm’s decision. In this context, a crucial element that management has to take into account is the voluntary disclosure’s cost, for this reason “the managerial decision on the degree of voluntary disclosure requires a specific cost-profit analysis”. Once the company has verified that the costs do not exceed the benefits of disclosing information, it can decide which type of data should be reported, hence, the materiality concept becomes the relevant determinant for this decision. In this context, it would be better to mention a study which was run by Heitzman et al. in 2010, emphasizing the relationship between materiality and voluntary disclosure. At the basis of their results, there have been posed three main alternatives:

1. the organizations should disclose data focusing only on their materiality;
2. the organizations should disclose information only on the basis of the incentives obtained by voluntary disclosure;
3. the organizations should disclose information both on the basis of its materiality and for the benefits of voluntary disclosure.

The research was conducted to verify whether a type of correlation exists between the two variables. As a result, in the first case, where the companies are forced to disclose a particular type of data because relevant, the incentives which the organization can gain from the voluntary disclosure would not be obtained; while in the second and third case, managers can decide to disclose voluntarily some data, and then they can focus on their relevance, so the incentives of voluntary disclosure are higher, because the market perceives the disclosure as completely voluntary, and therefore, the firm’s reputation is enhanced. As a matter of fact, materiality thresholds play a crucial role in the voluntary disclosure decision from company’s point of view.

Moving to the non-financial information materiality concept, it has been firstly developed with the Sustainability Report. The GRI has introduced its guidelines with

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the following statement: “The Guidelines identify information that is relevant and material to most organizations”\textsuperscript{123}; from this introduction it is possible to capture that the “information”, which should be reported by the organizations, should be “relevant” and “material”, implying that the two concepts are perceived as different one from another, and as a consequence they cannot be used interchangeably. The term material is defined\textsuperscript{124} as: “relating to, derived from, or consisting of matter” or “having real importance or great consequence”, while relevant matter is described\textsuperscript{125} as : “having significant and demonstrable bearing on the matter at hand”. From the previous linguistic definitions it is possible to better understand the difference between the two meanings, on one hand materiality is associated to both the importance and the consequences which an action could have, while on the other hand, the relevance is more connected to the demonstrability and the significance of an action. In general terms, it has resulted that it is really difficult to perfectly perceived the slight difference between the terms for the practitioners, and as a consequence, to put it into practice during the preparation of the reports.

As concerns the materiality definition only, the international body of GRI has provided a definition of what it is: “The report should cover Aspects that reflect the organization’s significant economic, environmental and social impacts; or substantively influence the assessments and decisions of stakeholders”\textsuperscript{126}. Once again, it would be better to focus the attention on the materiality meaning as it is perceived by the Global Reporting Initiative; the global body has defined the “material Aspects” as those which could have a “significant impact”, so, as already stated, the materiality is related to the consequences of actions, which, from a linguistic point of view, are defined by the “significant” term. In this case, “significant” is used as “having or likely to have influence or effect”, so from a theoretical point of view it could be used interchangeably with material.

Moreover, from the definition of materiality already stated by GRI, it is possible to extract two new perspectives: the obvious one consists of taking into account not only financial impact but also social and environmental ones, the second perspective is not so clearly expressed, anyway it consists of focusing the attention on both the impact

\textsuperscript{123} Magrassi L., Raoli E. (2018), “Rilevanza (e materialità) nella disclosure non finanziaria”, p.26, Consiglio Nazionale dei Dottori Commercialisti e degli Esperti Contabili
\textsuperscript{124} Merriam-Webster website, “Material - Vocabulary”, https://www.merriam-webster.com/dictionary/material
\textsuperscript{125} Merriam-Webster website, “Relevant - Vocabulary”, https://www.merriam-webster.com/dictionary/relevant
\textsuperscript{126} GRI (2016), “Defining what matters; Do companies and investors agree on what is material?”, p.8
on the company and the impact on external stakeholders. This second point of view could be better explained in the following sentence: “In defining the boundaries of each material aspect, organisations are asked to consider whether the impact falls inside or outside the organisation and to describe the boundary of each impact.” In this context, the materiality’s requirement becomes more difficult to fulfil, because organizations’ managers are required to choose the information to disclose on the basis of what is relevant both for the organization, and for its stakeholders, keeping in mind that no mandatory requirements are provided by any jurisdictions. The role of the managers is really tough due to the process that they have to perform in order to provide material information: “the process...involves selection, inclusion and exclusion of information” on the basis of their personal judgement, emphasizing a point of view which so far was typical of the financial report: “the overall aim was to focus less on ‘a company’s sustainability performance’ and more on ‘the quality of its disclosure’.

So the managers have played a relevant role in determining materiality, and in this context, it would be better to report a scheme which have been developed by the AccountAbility body, in order to simplify the determination process in Sustainability Report. It has consisted in five steps, starting from the identification and representation of “issues from a wide range of sources including the needs and concerns of stakeholders, societal norms, financial considerations, peer-based norms and policy-based performance”, to the evaluation of their relevance, taking into account “the changing sustainability context and maturity of issues and concerns.”

An interesting view related to the non financial information materiality in the Sustainability Report, has been described by Unerman and Zappettini in their paper, in which they have expressed the idea that the process of identifying what is material, and as a consequence, what should be disclosed, is extremely important, but at the same time, it would be extremely relevant also the “analysis of absence” of some data, because, they stated, “it (analysis of absence) has the potential to add substantive

insights\textsuperscript{131}. According to the authors, analyzing the events that the organizations decided to not disclose, could increase the level of comprehension about the reported data, understanding whether they are really material or not. For this reason, they have supported the materiality concept in relation to the processes that managers have to run to identify relevant information.

In the case of the Integrated Report, the materiality definition is slightly different from the previous one of the Sustainability Report: “a matter is material if it is of such relevance and importance that it could substantively influence the assessment of providers of financial capital with regard to the organization’s ability to create value over the short, medium and long term\textsuperscript{132},” implying that the materiality seems to be essential for the audience interested in making decision, which is composed mainly by the “providers of financial capital”, as in the case of the financial information materiality; and, the only requirement needed to report information is that it should affect the “organization’s ability to generate value”, no matter if the information is economic, social or environmental one. The materiality definition continues: “in determining whether or not a matter is material, senior management and those charged with governance should consider whether the matter substantively affects, or has the potential to affect the organization’s strategy, its business model or one or more of the capitals\textsuperscript{133};” in this context, the prominent role is performed by both the members of the Board of Directors, and the senior executives, who are accountable for development of the materiality concept in their organization. Proceeding with the understanding of materiality definition, it would be interesting to provide a sort of linguistic analysis as it has been made for the GRI guidelines. The IIRC has reported, in the Materiality Identification Process section, the following statement: “Not all relevant matters will be considered material. To be included in an integrated report, a matter also needs to be sufficiently important in terms of its known or potential effect on value creation. This involves evaluating the magnitude of the matter’s effect and, if it is uncertain whether the matter will occur, its likelihood of occurrence\textsuperscript{134}. A singular characteristic, in the above mentioned lines, consists of the specification that a relevant matter is not necessarily a material one. As in the case of GRI, a “relevant matter” could not be a


\textsuperscript{132} IIRC (2013), “Materiality, background paper for <IR>”, p.2

\textsuperscript{133} EY (2013), “The concept of materiality in Integrated Reporting”, p.2

\textsuperscript{134} Magrassi L., Raologi E. (2018), “Rilevanza (e materialità) nella disclosure non finanziaria”, p.33, Consiglio Nazionale dei Dottori Commercialisti e degli Esperti Contabili
“material matter”, meaning that specific actions, and so related data disclosed, could be important to some extent (becoming relevant), but if they would not cause “effect on value creation”, they could not be material as well. Once again, the difference between the two terms is not so robust, however, the IIRC has provided a complete scheme to follow (Materiality Identification Process) in order to facilitate the comprehension and the application of the materiality principle for the organizations.

Considering both the financial and the pre-financial information disclosure, an important issue to tackle consists of the thresholds in determining materiality. While for the economic data the companies have to follow a quantitative threshold, so they provide financial numbers which are then ensured by external audit firms, guaranteeing the materiality, in the case of non-financial data there are not exact quantitative thresholds according to which assessing materiality. The reasons why could be summarized in the following table:

<table>
<thead>
<tr>
<th>Non financial information</th>
<th>Consequence on materiality evaluation thresholds</th>
</tr>
</thead>
<tbody>
<tr>
<td>“It captures a wider concept of firm’s value creation”.</td>
<td>Assessing all the relationships existing in the value creation process is a really complex and time consuming process.</td>
</tr>
<tr>
<td>It is addressed to different stakeholders, with different interests.</td>
<td>“The issues considered may have an impact on different capitals”, so it is impossible to use a “unique threshold”.</td>
</tr>
<tr>
<td>“Non financial cannot always be expressed in monetary terms”.</td>
<td>It is not possible to easily state the extent to which an issue could be material.</td>
</tr>
<tr>
<td>“Non-financial information is often long-term oriented”.</td>
<td>It is tough to assess an issue which could be meaningful in the long term perspective, but not necessarily in the short term one.</td>
</tr>
<tr>
<td>It is affected by external factors other than the organizational culture and actions.</td>
<td>It is necessary to consider “events and phenomena which are external to the firm”.</td>
</tr>
</tbody>
</table>

As a consequence, the materiality determination process for non-financial data is not free from issues, which the organizations are trying to manage by their own, due to the lack of mandatory requirements. Even if, some helping guidelines have been

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provided by both GRI and IIRC to identify material topics, ensuring the non financial information materiality concerns the majority of organizations.

At this point, there exist materiality’s similarities between both the Annual Report and the Sustainability Report with the Integrated Report: in the first case as well as in the second one, the criterion at the basis of both financial and pre-financial information materiality is the “decision usefulness of information\(^\text{136}\)”, meaning that the data are disclosed with the ultimate goal of increasing the stakeholders’ awareness, about firm’s condition, for making future decisions; while the common element between Sustainability Report and Integrated Report is the focus on the materiality idea both from an internal point of view (within the organization) and from an external point of view (external stakeholders).

To summarize the materiality concept, it would be interesting to state the AccounAbility’s simile, to exactly represent how materiality should be perceived by the organizations: “Materiality is like packing a backpack for a hike: you can only bring the supplies that are absolutely critical, otherwise the weight will slow you down and eventually bring you to your knees\(^\text{137}\)”; meaning that organizations have to disclose those data which are really perceived to be “critical”, otherwise the risk of overloading the market with information would be real, with the immediate consequence of damaging themselves.

### 2.2 Materiality principles

In this section, the focus would be on the principles according to which the materiality is defined in the Integrated Report. Even if it could seem redundant, it would be better to remind the reader that no mandatory guidelines are provided to the organizations to define the material matters and to disclose them to the public audience. For this reason, the principles according to which firms establish material topics are subjective and not legally recognized. The first principle at the basis of the materiality in IR is internal to the firm, and it deals with a need essential for all the corporations: “value creation process”. “Information should be framed in terms of implications on


future value creation\textsuperscript{138}, implying that all the data collected by the organizations have to be categorized on the basis of their ability to influence the value creation process, so if they result to be influencing then they would be disclosed as “material”. In this context, the main challenge is strictly related to the definition of value created by the company, because, from an internal point of view, all the performed operations and the resources used seem to be crucial for the creation of value, so for the ultimate outcome, but, at this point, the organization has to consider the stakeholders’ interest in order to understand which are the most valuable outcomes from an external point of view. At this point, there should be a convergence in materiality concept between the organization’s point of view and the stakeholders’ one.

The second principle which underpin the materiality is the conciseness: “Disclosure about material matters in an integrated report should include concise information that provides sufficient context to make the disclosure understandable\textsuperscript{139}”. The conciseness, as perceived by the IIRC has been already explained in the first chapter, however, it would be better to provide some details about how both the organizations and the external stakeholders deal with this principle. In the first case, from an internal point of view, preparers of the Integrated Report, are involved in a really complex process, because, once they have collected all data needed, these data should be disclosed in a brief manner. In the first part of the process, the data collection and analysis, it is relevant the information system adopted by the organization, which could become the real issue that they have to tackle. A very simple statement that explain perfectly this issue is the following one: “When IS lack the capacity needed to collect, store, and transfer critical information for the business, decisions can be impacted and options limited. Customers will be dissatisfied or even lost. Production costs may be excessive. Worst of all, management may not be able to pursue desired business directions that are blocked by inappropriate IS\textsuperscript{140}”, implying that the information system allows the firm to clearly respond to the market’s needs or, in the opposite side, to cause a damage. So, when inappropriate data are provided, it is not only a managers’ fault, but also a lack of direction, due to the wrong choice of information system implementation made by the senior executives. From an external

\textsuperscript{138} International Federation of Accountant (2015), “Materiality in <IR>, guidance for the preparation of integrated reports”, p.10

\textsuperscript{139} IIRC (2013), “Materiality, background paper for <IR>”, p.10

point of view, the stakeholders need the IR to be concise in order to capture immediately the outstanding events that could influence their expectations about the firm. However, sometimes, conciseness implies that the information provided is not able to give a broad picture of the company’s situation. As a matter of fact, in the Integrated Report, all detailed data are not drawn up, because the managers preferred to report some specific contents in other reports published by the company: “additional detailed information about matter can be provided separately on the organization’s website or in the other forms of communication”, for this reason, the stakeholders have to take into account also all the others firm’s forms of communication; action that could be perceived as a time-consuming process, becoming a problem for stakeholders. So, if one hand the conciseness principle aims at improving the IR’s quality, on the other hand there exist some issues to face with, both for the organizations and for the stakeholders.

Other two principles which have been already exposed in the first chapter are completeness and comparability; both allow the organization to enhance the materiality of non financial information. The challenge related to these two principles, is mainly due to the lack of international mandatory regulation about pre-financial information disclosure. Organizations are free to choose the level of completeness of data, so they could provide some pieces of information thinking that they fully respect the completeness principles, being not aware that maybe these data are not complete. A suggestion could be given by the comparability level of information, but, as it was already stated in the work, the comparability level of non financial information is very low in the Integrated Report, hence, firms do not have actually tools to increase both the level of completeness and comparability due to the lack of clear market requirements. The lack of a fully completeness and comparability of data causes the organizations to lower their level of credibility, generating the so called: “symbolic management”, which “aims to positively influence stakeholders’ perceptions of the firm, engaging in apparent actions that lead key stakeholders to believe that the company is committed to societal requirements”, which is opposed to the “substantive management” that presents concrete actions to align the internal policies and performances to external environmental and social norms.

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141 IIRC (2013), “Materiality, background paper for <IR>”, p.10
To summarize, there are several principles according to which the materiality could be identified; in general, the quality of information provided could be assessed in three steps according to Michelon and her colleagues: the first step consists of analysing the “content” of the data, in order to define whether it is relevant and to which extent; the second step deals with the “type of information” disclosed, so the typology of data, the data format, which could be both numerical and narrative; the last step is focused on the “managerial orientation”, so how the managers perceive the non financial information disclosure, and as a consequence, how they work on it. All these theoretical phases could be really helpful for those organizations that are interested both in the Integrated Report’s provision and in the materiality principle fulfilment.

So far, the non financial information materiality has been identified due to principles which the companies could adopt; however, there are some features, both internal to the firm and external, that could enhance the materiality proposition; these features are commonly named “Determinants of materiality”. There are several academic papers which describe the “Determinants of materiality”, in particular they contain many hypothesis to verify which are the features that really influence the organization’s capacity of disclosing material information.

The starting point is the characteristic which is internal to the firm, as a consequence, the organizations have the possibility to manage the internal determinant of materiality, supporting it. The feature that is going to be analyzed is the “Board of Directors”, and its impact on the firm’s data materiality. In the Frias-Aceituno’s paper, the relevance of the Board of Directors (BoD) is introduced thanks to the following statement: “effective corporate governance strengthens a company’s internal control, and thus more information is disclosed in order to reduce the problems arising from opportunistic behaviour and from the existence of asymmetric information”, so in general the relationship between the BoD and the firm’s data materiality is highlighted. In order to better comprehend how the BoD’s decisions affect the level of materiality, it would be necessary to describe the different components of this determinant. The components proposed are several:

1. Size of the Board; even if some studies suggest that smaller boards are able to operate in a more effective way, due to the ease of finding a

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common opinion among members, there are others which strongly support the idea that larger boards are better in the case of disclosing material information. The reason why lies in the fact that “an integrated report requires the input of directors with different types of expertise, in accounting and finance sustainability, etc. And the presence of such a variety of expert viewpoints is more common in larger Boards”. As a consequence, the “variety” of the Board suggested by Frias-Aceituno would enhance the level of materiality because “larger boards are more likely to engage more often in discussions about what are the material issues for the company, as different board members represent different interests of stakeholders." In this context, several academics consider the BoD “size” component as positively correlated with the materiality issue.

2. Independence of the Board; “it is widely believed that a majority of board members should be independent of management”; and knowing that “an independent Board is considered an essential mechanism to control the actions of managers and to ensure shareholders’ goals are accomplished”, it would be better to analyze how the directors’ independence could affect the information materiality. As it was exposed by Fasan and Mio in their paper, the independence will ensure on one hand the reduction of management’s earnings, and on the other hand the information quality improvement. Therefore, it is strongly suggested to the organizations to reinforce the BoD independence for two main reasons: on one hand to achieve the stakeholders’ objectives, limiting the management’s power, while on the other hand to raise the amount of material data disclosed, in order to maintain their reputation as external directors. For this reason, the correlation between information materiality and Board of Directors independence is supposed to be positive.

3. **Activity of the Board**: before explaining the activities performed by the Directors, it would be better to introduce the four main duties\(^{148}\) that are at the basis of the members’ activities: “duty of care”, which consists of being able to make/delegate decisions; “duty of loyalty”, which implies that corporate interests will be always considered at first; “duty of good faith”, which imposes the directors to act in the best interest of the shareholders, and “duty not to waste”, which emphasizes the Directors’ role of protecting the firm’s value creation process. The consequent activities performed by the Directors, consist mainly in taking part at the meeting to manage properly the organization and making financial decisions which would increase the firm’s value. In this context, the component seems not to be relevant for the quality of information disclosure, as a consequence, many authors have suggested to consider this component as not so much influencing the materiality of data.

4. **Diversity of the Board**: in this context, in the Communication from the European Commission 2017/C 215/01, it has been emphasized the role of the diversity of the Board; it is stated that large companies have to disclose: “a description of the diversity policy applied in relation to the undertaking’s administrative, management and supervisory bodies with regard to aspects such as, for instance, age, gender, or educational and professional backgrounds, the objectives of that diversity policy, how it has been implemented and the results in the reporting period. If no such policy is applied, the statement shall contain an explanation as to why this is the case\(^{149}\)”, implying that large companies have the legal duty to disclose information about composition of their Board. Moreover, several authors have specified that the Board’s diversity has to be interpreted regarding the gender and the nationality. In the first case, Frias-Aciutuno has stated “In relation to gender diversity, several authors have argued that the presence of women at senior management level positively influences company behaviour...(because they are) applying ethical frameworks and criteria that differ from those


commonly used by men, while presenting more philanthropic interests and concerns\textsuperscript{150}, in the second case, it is well-known that grouping together people coming from different countries brings several advantages due to the different mind-set and habits, developing a strategy that could be perceived as international rather than national. As a consequence, for the nature of this pluralistic Board, the necessity of being transparent and reliable increases, and the level of information disclosure as well. For this reason, there seems to be a positive association between the firm’s materiality level and the Board’s diversity.

Even if all the above-stated components seem to be influencing with respect to the organizations’ materiality, several authors (Frias-Aceituno et al; Fasan and Mio)\textsuperscript{151} have proved that only “Size” and “Diversity” of the Board could really have an impact on the materiality of information provided. For this reason, the materiality’s determinant “Board of Directors” could be internally managed by the organizations in order to raise their level of credibility, truthfulness and transparency, due to the creation of a large BoD, composed by different professionals; this conclusion is clearly expressed in the following statement: “This process (disclosure supported by the BoD’s decisions) leads to an increase in transparency and, consequently, a reduction in firm’s capital cost, at the same time enabling enhancement of the organisation’s status and reputation\textsuperscript{152}.”

The second determinant is external to the firm, meaning that the organizations cannot influence this type of feature but if they understand how it works, they could gain benefits aligning their reporting process to the context’s requirements, enhancing the materiality level. The external determinant consists in the “Industry” where the companies decide to operate. In this context, there exist several types of industry but different authors have identified only two broad categories of industries, in order to better analyze the consequences of each type on the firms’ information materiality. The first group could be named “Manufacturing industry” while the second one “Non


manufacturing industry”. In the first category it is possible to group all those firms which have a strong environmental impact due to their business activities, and for this reason, they have to observe strictly legal requirements, being aware that they are considered to be accountable for any consequence not only at environmental level but also at social one. All the others firms which do not have a strong impact on the environment, take part in the second category.

The relation between these two types of industry and the materiality issue has been investigated by several authors. Taking into account the “Manufacturing industry”, it has been stated by Hassan and Ibrahim: “companies which have a higher pollution propensity are required to comply with more rigorous legal requirements. Companies belonging to carbon-intensive industries are perceived as being environmentally damaging, and therefore face greater pressure from stakeholders. As such, they have stronger incentives to disclose more environmental information”\footnote{Hassan A., Ibrahim E. (2012), “Corporate Environmental Information Disclosure: Factors Influencing Companies’ Success in Attaining Environmental Awards”, p.33, Corporate Social Responsibility and Environmental Management}; from the statement it is possible to capture that operating in a particular industry could heavily increase the responsibility of a firm with respect to its reporting process. The same idea is also supported by Monteiro and Aibar-Guzmán, who have written: “it is generally assumed that companies from environmentally sensitive industries tend to disclose more environmental information than firms from non-environmentally-sensitive industries”\footnote{Aibar-Guzmán B., Monteiro S.(2010), “Determinants of Environmental Disclosure in the Annual Reports of Large Companies Operating in Portugal”, p.188, Corporate Social Responsibility and Environmental Management}; so it is a general opinion that companies operating in the “Manufacturing industry” are more likely to provide non financial information to the public audience, mainly due to the “different pressure they receive from public opinion”\footnote{Fasan M., Mio C. (2017), “Fostering Stakeholder Engagement: The Role of Materiality Disclosure in Integrated Reporting”, p.292, Business Strategy and the Environment”.}

Therefore the main principles and determinants that organizations have to both adopt and being aware of, could be summarized in the following figure:
2.3 How to determine materiality

Once the Materiality concept has been explored in its components and its principles, it would be useful to focus the attention on how the organizations could identify material matters in practice; to do so, the most important international bodies have developed several processes and schemes that would be described in this chapter.

2.3.1 GRI’s Materiality Matrix

The first model that is going to be analyzed is the one provided by the Global Reporting Initiatives (GRI), which in 2016 has published the paper “Defining what matters; Do companies and investors agree on what is material?”, in which the body makes clear how the companies should behave in order to fulfil materiality principle. At the basis of the model proposed, there exists the GRI’s materiality idea already described in the previous section, so far it would be better to introduce and explain the process, named Materiality Matrix. The Matrix is the final representation of a more complex process that the organizations have to face with. It is composed by four main steps that are going to be evaluated:

1. “Identification” of material “Aspects”; each company should identify the actions performed which cause or can cause an impact from an

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156 GRI (2016), “Defining What Matters Do companies and investors agree on what is material?”, p.10-12
“environmental, social and economic” point of view. To do so, companies have to analyze both the indicators which are essential to its business, and their relative consequences on the internal and external context in which they operate. Once they have identified the most important “aspects”, they simply have to compile a list.

2. “Prioritization” of matters; once all the perceived material issues have been determined, the companies have to categorize them on the basis of their significance both from an internal perspective and from an external one, meaning that the organizations have to deal with a huge amount of data, trying to understand which are the really important for running the business and which are relevant for the stakeholders’ decision process. As a matter of fact, to properly run the prioritization process, the companies have to prove their ability in the identification of stakeholders’ interests, because only if the interests of each group are captured, the organizations could then provide meaningful information to the audience.

3. “Validation” of data; as already mentioned, the information should be trustable, balanced and transparent.

4. “Review” of the report provided; in this context, the firms require the stakeholders to provide them a feedback in order to understand whether they, the firms, were able to disclose the needed non financial material data. The review process is really important because through it the companies can both implement their materiality level and improve their disclosure process157.

The whole methodology would lead the organizations to identify the material aspects and to represent them graphically in the final Matrix, which is composed by two axis: the horizontal one represents the extent of the impact on the environment, society or economy; while the vertical axis represents the information’s influence on stakeholders’ decision process.

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The GRI has developed the Materiality Matrix mainly for the identification of material sustainable information (especially the environmental and social one), meaning that this visual representation could be really useful for all those data which cannot be easily expressed in monetary terms, and as a consequence, their relevance would be represented graphically to better capture their impact both on the business and on the stakeholders’ objectives. However, the Matrix is a tool which requires a high level of comprehension of the factors’ impacts, and high level of managerial skills to prepare it. As a consequence, it seems to lose its effectiveness because organizations risk to waste time in preparing the visual representation, instead of improving the quality of their non-financial disclosure. Moreover, it would be better to remember that this methodology should implement the materiality level, and as consequence, the comparability of information among firms, but there are not explicit factors that organizations have to categorize as material, so each firm can choose what it considers to be material. At the end, the tool could generate confusion among companies, because even firms belonging to the same industry would disclose different relevant topics, creating chaos among stakeholders’ ideas and missing their original objective.

2.3.2 AccountAbility’s Materiality Determination Process

A similar approach has been developed by the AccountAbility body, which has provided a Framework to help organizations in defining what is material: the

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158 GRI (2016), “Defining What Matters Do companies and investors agree on what is material?”, p.10-12
Framework consists of the same contents already introduced by the GRI, except for the new element of aligning the materiality determination process with “the company’s ongoing processes of strategy development, performance management, reporting and stakeholder engagement”\(^{159}\). In this context, the materiality issue is treated in relation to these four perspectives: the “strategy”, the “performance”, the “reporting process” and the “stakeholder engagement” of the organization. In the first case, pinpointing the material matters is necessary to comprehend how they could affect the firm’s strategy, both in positive terms, highlighting the future opportunities to seize, and in negative terms, underlying the possible threats to face with. As regards the organizational performance, it is related to the review of material topics, because comparing the current performance with the current material aspects, could give the organizations the opportunity to understand whether they have made an optimal decision about the materiality or, on the contrary, if they have to change some material topics because they have been resulted to not be as much material as they seemed. In the case of reporting process, the relation with materiality could help the companies in determining the internal policies to follow, and in aligning the actions needed once they have perceived which are the really relevant matters. In the end, the stakeholder engagement is necessary to catch what stakeholders want and to align their interests with the firms’ goals. The AccountAbility body represents its stages of determining materiality using a graphical representation of three circles interconnected each others. Even in the case of the AccountAbility’s materiality determination process there exist some advantages and some drawbacks that the tool causes. On one hand, it is already stated that this methodology puts into relation the materiality concept with the most important perspectives that firms have to consider: strategy, performance, reporting process and stakeholders’ engagement. This could be considered as real advantage because the AccountAbility body has showed that it has comprehended the importance of all organizations’ activities, both internal and external. However, the main drawback consists of the lack of direct factors to be analyzed, as in the case of Materiality Matrix; each firm has the opportunity to choose its own material matters, but this could cause misunderstanding and misalignment among companies and their stakeholders.

2.3.3 SASB's Materiality Map

So far, the focus was on the IR’s principles and the tools used mainly at European level, but in this section, it will be better to describe a materiality’s tool which is adopted in the United States, just to underline that the materiality identification process is considered to be an issue at global level. The methodology that is going to be analyzed has been developed by the American Sustainability Accounting Standards Board (SASB), which has defined itself as a “standards-setting organization for sustainability accounting standards that meet the needs of investors by fostering high-quality disclosure of material sustainability information\textsuperscript{160}, implying that its aim is to provide the best-quality information to the investors, protecting in this way the American market. This above mentioned “shareholder’s view” is emphasized also as regards the materiality issue, to which the SASB has reported: “Materiality is a fundamental principle of mandated disclosure in the United States. The concept of materiality recognizes that some information is important to investors in making investment decisions”. It is immediately clear that the European perspective differs from the American one for the audience to which the sustainable information is addressed to, and for the ultimate goal of providing non-financial data, on one hand the European bodies aim at protecting all the stakeholders involved with the organizations, while, on the other hand, the American entity tries to protect the capital providers mainly.

However, the attention should be posed only on the materiality tools improved by the SASB; it is named “Materiality Map”. The tool is slightly different from the ones provided by the GRI and the AccountAbility body because it is based on what is perceived as relevant by the organization with respect to the existing and the potential investors, meaning that all the stakeholders’ groups do not have the same importance; as a matter of fact SASB has clarified its position stating: “SASB standards address the sustainability topics that are reasonably likely to be material and to have material impacts on the financial condition or operating performance of companies in an industry”. Another element which is in contrast to the previous tools is the fact that the Materiality Map specifies which should be the material matters for each industry, so the regulatory body “is working to establish industry-based materiality standards for each of the 88 industries in the Sustainable Classification System\textsuperscript{161}”. In this context, this is a

\textsuperscript{160} SASB website, https://www.sasb.org/about-the-sasb/

\textsuperscript{161} AccountAbility website (2013), “Redefining Materiality II: Why it Matters, Who’s Involved, and What It Means for Corporate Leaders and Boards”, p.12, https://www.google.it/search?q=Accountability+materiality&oq=Accountbaility+materiality&aq=chrome..69i57j0i5.4414j0j8&sourceid=chrome&ie=UTF-8
really interested perspective, because SASB has taken into account the fact that a materiality’s characteristic is to be “industry-based”, as stated in the first part of this chapter, and it has decide to provide a tool which could be perceived as really helpful by the organizations. The Map is developed in the following way: at first, there is a list of the industries in which the company has to place itself; secondly, once the industry has been specified, the sustainable categories for each type of industry are listed, in this way, the company exactly knows which are the material issues to which it has to deal with; for each sustainable category, the company would receive a score related to its quality of disclosure, and it could compare its own score with the average score of the industry. Moreover, to prove that the category is material, the financial impacts that it could generate are specified, so the company would have a validation.

The Materiality Map seems to be more easy to use, due to its extreme schematization, enhancing both the level of comparability among firms and the level of materiality. However, the contents are only related to the financial performance of the organizations, implying that the influence of this sustainable factors is analyzed only from a monetary point of view, excluding the environmental and societal impact of the firms. So, even if the initial idea was to develop a toll useful for disclosing non financial information, in the end, the methodology is still used according to a financial perspective, which explains why the audience is composed exclusively by capital providers.

2.3.4 IIRC’s Materiality Determination Process
The last tool that is going to be analyzed is the one provided by the IIRC. First of all, it would be better to emphasize the fact that, according to IIRC, it is not only important to disclose material matters, but also, it is necessary to provide the audience with the process adopted for the identification of these material topics; the international body requires the process’s disclosure as well as the pre-financial material information disclosure. The process developed by the IIRC is quite complex, composed by three main steps to follow for the organizations, each of them is described in details in this section.

1. “The Relevance”; in the first step the difference between relevant and material turns up once again. In this case the “relevant” is interpreted by the IIRC as “those matters that have a past, present or future effect on
the organization’s ability to create value\textsuperscript{162}, and once the firm has pinpointed the relevant matters it could start to identify the material ones. As a consequence, being a relevant factor is the necessary condition to become material later. The relevance identification process is a firm’s internal activity, which is performed by senior management. It is composed by several passages\textsuperscript{163}:

i. Senior management has to “\textit{consider the organization’s value drivers}”, implying that it has to know exactly which are the drivers that generate competitive advantages for the organizations, implying that it has a deep knowledge and awareness of what is able to support the activities with respect to competitors.

ii. It has to “\textit{consider other factors internal to the organization}”, in order to capture which are the processes and capabilities that the companies is using to run the operations.

iii. It has to be aware of who are the relevant stakeholders and their relative interest, to capture which could be the relevant factors also for them.

iv. It has to take into account “\textit{factors external to the organization}”, because the firm is operating in a broad context with many uncertain conditions.

v. Finally the management has to collect all the factors cited above, and to understand whether they influence or not the firm’s value generation.

The relevance determination process requires management to show very high level skills, and capability of interpreting the factors taken into account in the right way.

2. “\textit{The Importance}”; once the organization has defined the relevant matters, it has to establish whether it is important or not. In doing so, the companies have to analyze the impact of the factors defined as relevant. It would be better to remember that the relevant factors could be

\textsuperscript{162}\textsuperscript{163} IIRC (2013), “\textit{Materiality, background paper for <IR>}, p.3
\textsuperscript{163} IIRC (2013), “\textit{Materiality, background paper for <IR>}, p.4-5
categorized in two groups: on one hand “some matters will be certain (…historic, or those mandated by regulation)”, while on the other, some could be “uncertain” to occur. In this context, the likelihood of occurrence is necessary to determine the importance of the factors. In the first case, considering the factors that will occur for sure, “the magnitude of the effect needs to be assessed to determine the importance of the matter”. To evaluate the “magnitude”, it would be necessary to investigate: the nature of the impact, so if it is qualitative or quantitative, the area that will be affected, so if it is going to influence the internal context or the external one, the time of the effect, so if the impact will be on short-term or long-one. Once all the already stated characteristic have been identified about each factor, the firm would be aware of whether the information is important, and whether it has to be disclosed.

In the second case, where there exists a certain percentage of uncertainty of occurrence, the organization not only has to analyze the “magnitude” already described, but also, it has to evaluate the “likelihood of occurrence” of the matter. In the following scheme provided by the IIRC, the two perspectives have been put in relation each other in order to capture whether a factor is material.

![Diagram](image.png)

**Figure 8- Importance of an Uncertain Factor**

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From the scheme it is possible to understand that the matters that are going to be considered material are those which will show both a high “likelihood of occurrence” and a large “magnitude”.

In both cases, the importance could be really difficult to assess, however, the potential material factor cannot be “excluded simply because their importance cannot be easily estimated”.

3. “The prioritization of material matters”; once both the first and the second steps have been developed, the “prioritization” of matters occurs, and, as it was already stated, the senior management are involved at this stage: it has to disclose the material matters in the report.

The IIRC’s Materiality Identification Process seems to be more complete than the GRI or the AccountAbility’s methodologies, but it presents the same critical issues of the previous ones.

At this point, in this section several tools, through which it is possible to fulfil materiality, have been analyzed. However, even if international bodies such as GRI, AccountAbility body, SASB and IIRC have provided the organizations with these methodologies, it is still difficult to ensure the materiality principle for the organizations, for two main reasons: on one hand, the companies are not subject to mandatory regulations, meaning that the materiality principle’s application is not controlled by external regulatory bodies, and as a consequence, the companies can decide whether to disclose material information or not; on the other hand, even if the tools are provided, they are not so effective because they all are structured in general terms, without taking into account the industry’s characteristics (a part from the SASB’s Materiality Map), and for this reason the comparability principle is lowered once again; as a matter of fact it would be more efficient to identify: “issues that are important to a reasonable investor. Applying them at the industry level, rather than the company level, provides a mechanism for identifying issues that all companies within an industry face. These issues are comparable because companies within an industry tend to have similar business models; they operate within the same regulatory environment, have similar approaches to handling resources and externalities, and produce similar products and services. Therefore, the material sustainability risks and opportunities facing companies within an industry are similar". In general, nowadays the organizations are not

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motivated in both developing and ensuring the materiality principle, because they would incur in worthless high expenditures for both of the processes, with relative scarce advantages to gain, due to the fact that the disclosure of material matters is not so fairly recognized as a very necessary and innovative action.

2.4 Materiality’s Benefits and Issues

The materiality principle has been investigated in details in the previous section, but both the benefits that the organizations could gain by adopting it and the issues that they have to tackle, have not yet been exposed. In this section there are going to be analyzed the consequences, both negative and positive, that materiality could bring to companies.

2.4.1 Potential Benefits to Gain

Both the companies and the market could ask whether it would be advantageous to improve and support the materiality principle, in order to disclose only material information. The reason why could be explained by several benefits that the material voluntary information disclosure could lead to organizations, even if currently they are not already available and perceived as “benefits”. Before exposing which could be the possible advantages to gain, it would be better to remember that at the basis of materiality principle’s development there is the organizations’ willingness to disclose data voluntarily, so all the benefits related to the voluntarily information disclosure would be already in place. Moving forward, the enhanced benefits brought by the materiality development are several and they have been investigated in many studies; in this section they would be analyzed in details.

The first good aspect is related to the impact on the capital market and how it perceives the disclosure of material information. Once an organization has decided to publish the Integrated Report with material information, it would have an immediate impact on its “access to capital”, meaning that it would cause “a significant impact on the share price of the organization (itself)\textsuperscript{166}”. This hypothesis is supported by several authors such as Barnabè et al. in their paper as well as Healey an Palepu in theirs; especially the formers have stated: “the IR publication, disclosing material information of an organization, significantly affects the share price of that organization”. At the basis of this concept there is the idea that the disclosure of material data could strongly

influence the investors' decisions process, and that the capital market, could perceive the real value created by the company considered. The same Healey and Palepu explained: “for firms with high levels of disclosure, investors can be relatively confident that any stock transactions occur at a “fair price,” increasing liquidity in the firm’s stock”, implying that higher the level of reliable data, higher will be the effect on the stock price. In a similar perspective, Garcia-Sanchez et al. have highlighted the so called “Signalling Theory”, which could be described as the companies’ willingness of providing the market with information in order to give it a signal, to be recognized by the capital market itself. Giving a signal implies that the “advantages related to information disclosure are associated with an improvement in investor trust, greater stock liquidity”, remembering that at the basis of this benefit there is the belief that the data provided are trustable and relevant. It is possible to conclude that, from a market perspective, this benefit related to the materiality principle is quite the same of the benefit generated by the non financial voluntary information, meaning that the market does not already require the firms to provide only material information, but it settles for general non financial data without focusing the attention on whether they are material or not.

The second positive advantage is still related to the voluntary information disclosure, and it has been already explained in the first chapter: the disclosure of material non financial information could lower the information asymmetry problem. In this context, Healey and Palepu already emphasized the role of information disclosure in the information asymmetry issue, stating: “investors demand a risk premium for bearing information risk when there is an information asymmetry between managers and outside investors”, meaning that when the existing and potential capital providers perceive to not be aware of all the necessary information about the firm, they ask for a “premium” in order to protect themselves, causing an increment in the cost of capital, from an organizational point of view. In this context, if the organization is able to disclose reliable data, the “key stakeholders may have greater confidence in the

information” and the “capital costs are lower, and access to capital is facilitated\textsuperscript{170}, so it results to be in the best interest of the organization to provide the market with all the necessary data.

In general, the companies could benefit from the materiality principle application by enhancing the positive effects already generated by the voluntary non financial information disclosure; so, it is possible to state that, nowadays, the materiality principle is not creating particular benefits by its own, but, it would be possible in the future if the regulatory bodies would provide more efficient tools to identify material matters, with the potential benefit of aligning the expectation about the IR with the reality, increasing the number of companies producing the IR, enhancing the awareness of operating in a sustainable way and empowering the comparability principle among firms operating in the same industry.

2.4.2 Existing Issues to Solve

Even if the benefits related to the materiality are not already reached by the organizations because they are working on the principle, there exist several open questions and issues to be solved. The first negative point which is going to be analyzed deals with the fact that both positive and negative information could be disclosed if it has been perceived to be material; as matter of fact , it seems to be quite obvious that the materiality principle embodies the fairness of firms’ conditions, so it is a duty of each company to represent the data on the basis of their “material nature” and not on the basis of their positivity. The concept is reported by Ernst & Young, which has underlined this materiality’s challenge: “investors may be deterred if both positive and negative matters are disclosed in an attempt to achieve a balanced and transparent reporting\textsuperscript{171}”. According to this perspective, companies should be both self confident and ready to disclose all types of information, and prudent in disclosing them in order to avoid stakeholders’ misunderstandings.

However, an additional issue could arise in the context of positive and negative information disclosure: companies could publish negative information just to be acquitted of reporting negative events that they had to face, increasing the stakeholders’ perception of being transparent, but, not all the negative events are material, and for this reason there should have been no need to disclose them. The idea is better described by


\textsuperscript{171} EY (2013), “The concept of materiality in Integrated Reporting”
Unerman and Zappettini, who have stated: “the reporting of individual incidents or events in news reports is not always sufficient to make these incidents or events material in the overall context of the organizations responsible for the negative social and/or environmental incidents or events”\(^\text{172}\). As a consequence, fulfilling the materiality principle does not mean providing any kind of negative data just to be sure that the market believes the company to be reliable, also in the case of negative events, the firm has to run an analysis to capture whether the information could be relevant or not for the audience, so the company has to “focuses on and investigates the process of materiality rather than assuming a priori intentionality from the outcome of this process”\(^\text{173}\).

A second challenge consists of losing a competitive advantage. If the companies decide to adopt the materiality principle, this implies that they have chosen to disclose relevant information from a strategic point of view, with the subsequent possibility of damaging the competitive advantages. As a matter of fact, in the competitive arena: “it is worth emphasising the costs derived from competitive damage, since the information would be public not only for current and potential investors, but for competitors, who could detect possible opportunities to improve their market positions”\(^\text{174}\); from the first chapter, the reader has learnt that the Integrated Report requires the organizations to disclose both their business model and their strategic objectives, but, if on one hand the companies satisfy these conditions, on the other hand, there exists the real possibility of being attacked by the competitors, which could jeopardize the “threats of takeovers or mergers”.

Another issue could be related to the loss of control once the organization has decided to disclose material information, in fact: “matters disclosed may be outside the organization’s control” according to EY. The immediate consequence would be that the company could not be able to manage all the explanations asked by several groups of stakeholders, because: “the information would be also available for other interested users, such as governments, trade unions, consumer associations, clients or suppliers, thereby leading to likely increases in pressures on the firm” as García-Sánchez et al. suggested. So, the company could find itself in a very inconvenient condition, being


forced to “increase the political costs, both direct and indirect..if disclosures reveal, for example, situations of monopolistic advantage or social inequalities\textsuperscript{175}”. In general, disclosing material information exposes the company to several forces, which could not be friendly, because the stakeholders could exploit the material information to enlarge their own benefits; for this reason, the organizations have to maintain their integrity, asking themselves “which stakeholders are most influential in affecting the direction of integrated reporting standard setting?\textsuperscript{176}”, in order to be able to advise the regulatory bodies and the legal entities in case of hazy events.

Another problem that has to be considered in relation to the materiality principle is the challenge of disclosing information about the company’s future orientation. EY has emphasized: “there may be potential liability if matters do not materialise as previously disclosed in the future-oriented information\textsuperscript{177}”; the sentence means that the companies have not to provide specific data about future projects’ results, but they have to publish information about their future plans, allowing the stakeholders to run their own conclusions. However, if the organizations both report data about future trends and ensure that the data are material, in the case of lack of achievement of these plans, they would damage their firm’s value, showing that they have not been able to predict properly future expectations. The materiality principle in some way aims at ensuring the reliability of information provided, encouraging the stakeholders to trust the organizations, but, if company fails, the stakeholders’ perception about the firm would be compromised and they would not be willing to invest again in an unreliable company. Moreover, it would be better to remember that the organizations have the duty to publish both positive and negative information also about future orientation to guarantee a fair balance among data. However, if on one hand, the company has to respect the principle of IR, on the other hand, reporting negative information about future plans is not perceived as a good move by the market, in fact “future information is not necessarily always positive and, in this sense, can affect corporate value negatively\textsuperscript{178}”.

\textsuperscript{177} EY (2013), “The concept of materiality in Integrated Reporting”
The major issue related to materiality is how companies could assure information provided. The data assurance is going to be analyzed in details in the next chapter.

So far, to summarize the milestones related to the materiality principle, it would be useful to remind that the materiality is necessary to guide the firms themselves during the disclosure process, in order to avoid to get them lost in the process and to not be overloaded by the huge amount of data. From an external perspective, the materiality is needed to ensure the stakeholders to read only relevant information that could really influence their own decisions about future investments. However, there exist several drawbacks related to this principle, mainly due to the lack of experience, standards and rules provided to companies. In particular, the main disadvantages that the Integrated Report is demonstrating with respect to the well-known Annual Report are: “standardization, comparability and assurance” of information. As long as the companies will not fulfil completely these three parameters, the Integrated Report would not be perceived as an innovative and really beneficial tool to adopt.

3 Connectivity of Information

Once the Integrated Report structure has been analyzed and described, and the material matters have been identified, it would be better to focus the attention on a specific issue which the organizations have to face with.

3.1 The Connectivity and the Integrated Thinking

The Connectivity of information is one the most innovative and controversial IR’s Guiding Principle and it is going to be explored in this chapter. However before moving to the Connectivity description, it would be better for the reader to recall the milestone at the basis of the Integrated Report: the Integrated Thinking concept. The definition of Integrated Thinking has been already provided in the first chapter, but, reporting a brief description could be helpful to clearly capture the relation between the Integrated Thinking concept and the Connectivity of information issue.

The “integrated thinking allows an efficient and productive capital allocation to ensure not only financial stability and value creation, but also sustainability in the short, medium and long terms\textsuperscript{180}”, it is quite easy to comprehend the statement already mentioned, which is mainly composed by three pillars:

1. “the efficient and productive capital allocation”, which implies that the organizations should be able to effectively allocate its resources in order to exploit them in the best possible way, avoiding wastes both in terms of time and in terms of money;
2. “ensure financial and sustainability stability”, which means that the firms should aim at reaching both the financial targets and the social & environmental ones which allow them to competitively remaining in the market;
3. “short, medium and long term”, both the previous goals should be pursued in the short term as well as in the long one, meaning that the companies should be aware of their future direction and their strategy should be aligned with their expectations;

As a matter of fact, the Integrated Thinking aims to ensure the company’s “survive-ability” in the future, looking at the current actions undertaken. The ultimate goal consists of giving the organization an overall picture of: both the external market in

which it is operating and the internal organizational environment; how its activities are run and which resources, both “human” and “material” are used; which targets are reached and which have to be achieved; how it could survive in the future, adopting the strategy, the activities and the resources to the market changes.

The Integrated Thinking can be perceived as the optimal orientation which all organizations should want to have at their basis, however, it implies huge efforts both in term of costs and in terms of knowledge, which not all the firms are able to deal with. So, the Integrated Thinking is so strongly interrelated with the Integrated Reporting that the IIRC has stated: “Integrated thinking is the basis for integrated reporting. The experience has shown that integrated reporting in an organization further helps to embed integrated thinking. Therefore, the processes of Integrated Reporting and integrated thinking are mutually reinforcing"; the reason of the interrelation lies in the fact that Integrated Thinking is the Integrated Reporting from an idealistic point of view, and as a consequence, once the Integrated Thinking has been adopted by a firm, the Integrated Reporting would be the immediate effect, as a kind of signalling input to the market. At this point, it would be interesting to understand how the Integrated Thinking could be translated into the Integrated Reporting process: through the Connectivity of information, which is going to be analyzed.

The Connectivity of information has been already introduced in the first chapter, however, in this one it would be analyzed in more details. Once again the IIRC has defined the connectivity in relation to the <IR> as “a comprehensive value creation story, the combination, inter-relatedness and dependencies between the components that are material to the organization's ability to create value over time”. From the statement it is possible to identify some interesting features that would be helpful in identifying the connectivity:

1. “combination, inter-relatedness and dependencies”; the first term, “combination”, is quite easy to understand for the reader, it could be expressed as the “result or products of combining”, so two elements are mixed together, giving a third results; the “inter-relatedness” means that there exists a “mutual or reciprocal relation” between two

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182 IIRC website (2013), “Connectivity, background paper for <IR>”, p. 4
matters, while the “dependence” has a different connotation: “the quality or state of being influenced or determined by or subject to another”\textsuperscript{185}. So, at the basis of the connectivity of information there are several types of relations between different objects; the relation depends on how the subjects could be linked to one another, so they could be at the same level, creating a mutual relation, or they could be a different level, implying that a subject could affect another one, or irrespectively to their position, they could be combined.

2. “between components that are material”; this brief caption explains the passage before establishing the relation between two subjects. As a matter of fact firstly the organizations have to be aware of which are the material matters, both in terms of capitals used and in terms of information disclosed, and then they can investigate on their connections and relations. The materiality assessment is the antecedent of the connectivity one, and so every firm has to ensure to be in compliance with the materiality principle to effectively identify the connectivity of information.

3. “material to the organization’s ability to create value over time”; once again, at the basis of the materiality, and as a consequence of the connectivity analysis, lies the value creation process as a whole, so the application of the integrated Thinking. All the subsequent studies could be run only if the company has defined its own value creation process, clarifying which are the resources use, capabilities adopted and results obtained.

3.2 Types of Connectivity

The connectivity seems to be a quite difficult process to be understood in theory by the companies, and as a consequence to be translated into practice. The IIRC has provided some specific guidelines\textsuperscript{186} in order to better identified those matters among which the connectivity could be established:

Connectivity among Content Elements


\textsuperscript{186} IIRC website, “The International <IR> Framework”, p.17
The “combination, inter-relation or dependence” among different Contents could be identified in several ways. First of all, the organizations should have their focus on the strategy and how they are willing to pursue it in terms of resources, so which would be the future achievements and which are the internal and external capabilities that would be adopted. To reach ambitious goals and to boost the economic growth, the companies should also be aware of the potential risks and opportunities that they would have to cope with, in order to act effectively and to reduce their wastes both in terms of expenses and in terms of time. The strategy could be planned in relation to the firm’s business model, which defines the essential operations through which the company runs the business on one hand, giving a clear perspective of which is also the external market to take into account. So, all the activities should be managed in the properly, and to ensure that they are undertaken in the best way, the governance is put in place, both to ensure the efficiency of the organization and to be held accountable whether the expectations would not be met. So far, it seems to be quite natural to operate in an organizational “integrated” way, putting into practice the Integrated Thinking and recognizing that all the Content Elements are strictly related to one another, however, it would not be so easy to clarify and specify each correlation between two or more Contents.

**Connectivity of the past, the present and the future**

Other possible correlations should be identified among past, present and future activities or information. All the organizations tend to look at their past in order to capture how they could move in the present or even in the future, and this has resulted to be a positive approach for many years. However, since the market condition is characterized by an extreme uncertainty and by an exponential innovation to face with, the companies should try to predict the future market trends in order to develop the current activities, ensuring their survive-ability. As a consequence, it is no more sufficient to link the past to the present and then the future, because it is now becoming relevant the opposite process, so be inspired by the future performance to build the current business plans. Creating linkages among these time horizons, especially from a future perspective to a current one, could be an extremely difficult process for the organization because high level skills are required in order to be enough self-confident in the expectations, and as a consequence, in supporting the current actions.

**Connectivity of Capitals**
Other interesting connections could be drawn up looking at the Capitals proposed by the IIRC. The connectivity among capitals is described as the “trade-offs between the capitals, and how changes in their availability, quality and affordability affect the ability of the organization to create value”. The above mentioned statements is quite clear on defining the how the connectivity exists among capitals. The organizations have to identify how much each capital could be able to affect the others’ existence and affordability and as a consequence, how much the organization’s ability to create value is influenced. To provide an example of which could be the trade-offs among capitals, it would be better to recall the section “the Capitals” from the first chapter, where the interdependencies among them are highlighted, and the reader could easily understand the meaning of connectivity among capitals.

<table>
<thead>
<tr>
<th>Capitals</th>
<th>Influence on:</th>
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</thead>
<tbody>
<tr>
<td>Financial</td>
<td>✓ Manufactured  &lt;br&gt; ✓ Intellectual  &lt;br&gt; ✓ Human  &lt;br&gt; ✓ Social &amp; Relationship  &lt;br&gt; ✓ Natural</td>
</tr>
<tr>
<td>Manufactured</td>
<td>✓ Financial  &lt;br&gt; ✓ Intellectual</td>
</tr>
<tr>
<td>Intellectual</td>
<td>✓ Financial  &lt;br&gt; ✓ Human  &lt;br&gt; ✓ Social &amp; Relationship</td>
</tr>
<tr>
<td>Human</td>
<td>✓ Financial  &lt;br&gt; ✓ Social &amp; Relationship  &lt;br&gt; ✓ Intellectual</td>
</tr>
<tr>
<td>Social &amp; Relationship</td>
<td>✓ Intellectual  &lt;br&gt; ✓ Human</td>
</tr>
<tr>
<td>Natural</td>
<td>✓ Manufactured  &lt;br&gt; ✓ Intellectual  &lt;br&gt; ✓ Social &amp; Relationship</td>
</tr>
</tbody>
</table>

Table 4- Connectivity among Capitals

*Connectivity between financial information and other information*

In this case the connectivity seems to be a really stretch goal to achieve due to the difficulty in establishing the relationship between financial information and other non-financial data. It represents an issue for the organizations because it requires the ability to comprehend how the narrative information could create value for the stakeholders,

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187 IIRC website, “The International <IR> Framework”, p.18
and how this value could be transformed into a financial one, so into a really important feature both to take into account and to be held responsible for. Identifying this type of connectivity reflects the Integrated Thinking of the company. In this context, the connectivity is strictly related to the concept of “quantitative and qualitative information”; the firm should be able to link the qualitative data to quantitative results. Sometimes it results to be difficult to monetize some narrative figures, especially because some of them could lose relevant meaning in the conversion, however, it would prove to the most reluctant shareholders that the non financial data could be really valuable for the organization as a whole.

*Connectivity of management information, Board information and information reported externally*

In this case, the connectivity reflects the alignment of data used internally and provided externally, so, the internal features adopted to evaluate the performances should be shared by people at all level of the organizations and should be the same provided to the external market. It is fundamental to align the data, however, some inconsistencies could arise, damaging both the internal financial results and the external firms’ reputation.

As already explained, there exist several forms of connectivity which can be identified, and all of them foster the Integrated Reporting process because the direct consequence of establishing interdependencies consists of disclosing all data in a better way. So, the connectivity of information could be perceived as the “trait-d’union” between the Integrated Thinking and the Integrated Reporting; it supports the communication of information highlighting “how an organization’s strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value over the short, medium and long term”\(^{188}\), which is basically the definition of the IR’s aim. The connectivity appears to be relevant and essential to draw up an Integrated Report because it allows the company to be more aware of which are the cause-effects leading to the value creation process or value destruction; the connectivity enhances the organization’s awareness of its value creation process.

However there is an issue which the organizations have to cope with in order to manage the connectivity identification process.

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3.3 How to measure connectivity

All the companies try to overcome the most difficult issue related to the connectivity of information, it consists of providing a reliable measure of the connectivity among different subjects involved, so on which basis it is possible to affirm that there exist a low, medium or high level of connectivity among two or more features taken into account. The process seems to become even more complex when the features analyzed are the non-financial ones.

Before focusing on the criteria to evaluate the level of existing connectivity, it would be better to explain the reader why the pre-financial features have to be considered so relevant to be integrated in the connectivity measurement process; especially it would be really useful for the audience interested in the financial data only, expecting that the non-financial resources would not affect the financial results of a company.

First of all, it would be helpful to define the non-financial measure as “intangibles” resources, so as resources that usually are not related to a monetary perspective, even if they are able to support the ultimate financial performances of an organization. For example, from a strategic point of view, the organizations which pursue continuously the products’ innovation or the products’ quality are not so able to quantify in monetary terms what innovation or quality mean for their business, but both the strategies certainly give the companies a sort of competitive advantage, which is transformed into profitability at the end of the process. Another example is represented by the employees relevance, which constitutes the so called Human capital, in fact “human and structural capital have direct effects on financial performance in non-manufacturing firms\textsuperscript{189}”, because the employees represent the core of the business, the unique resource that the non-manufacturing companies adopt, as well as the manufacturing companies have to take into account employees’ motivation in order to ensure that the performance provided are always at the highest possible level. A similar perspective is reflected by the importance of the customers and their satisfaction, two elements which highly influence the firm’s reputation and, in the long-term perspective, its profitability.

So, once the importance of pre-financial results have been perceived by both the shareholders and the company itself, and once the level of connectivity should be measured, it would be better to proceed with different solutions proposed by several

authors, in order to capture how the connectivity level could be assessed in the best way.

First of all, according to the authors Rivera-Arrubla and Zorio-Grima\textsuperscript{190}, the organizations have to ensure the existence of connectivity, supporting what they have defined the three main “antecedents conditions”. Both the authors have strongly agreed with the fact that the Integrated Report should be the next reporting process, however, what they have also stressed is that the connectivity implies communication between the company and the society and, even if the reporting process is introducing itself as a new and innovative way of communicating information, the channels through which these data are disclosed seem to be too much old. In this context, their research on the connectivity development and the social media takes place. Even if “research on social media and corporate reporting is still scarce”, they have been able to identify three conditions necessary to promote the connectivity of information:

1. “Information quality”, which obviously requires the company to disclose only high-quality data, ensuring the company’s possibility to establish a connectivity level later on. According to the authors, the data quality consists of three subsequent categories:
   
i. “auditors”; the quality of information is enhanced if the financial statements are audited by one of the Big Four.
   
ii. “assurance”; the quality of data goes up if the social and environmental information is guaranteed by an external assurance.
   
iii. “listing”; the quality is further risen if the company is listed due to the presence of “market supervisors”.

2. “Corporate characteristics”, which identify the organizational structure that could influence the availability of data in the end. The factors taken into account in this perspective are:
   
i. “leverage”; so its financial structure, knowing which is the proportion of equity with respect to liability; it is needed to clearly understand which are the main groups of stakeholders interested in receiving the data.
   
ii. “roa”; the return on asset provides a measure of the firm’s performances, which have to be communicated to the external

audience, so being aware of the internal results is fundamental to provide complete information.

iii. “size”; so the number of employees, because it could impact the process of storing the data and as a consequence the disclosure of information.

3. “Communication factors”, which can even facilitate the communication process or prevent it. The factor included in the analysis are:

i. “pages”; so the number of pages available for the organizational report, which could strongly impact the communication skills of a company.

ii. “use of social media channels”; so the usage of social media channels and the type of channel could have a substantial impact on the information reporting process.

Having stated that, the authors strongly believed that only if these three factors are pursued and ensured within any firm, it would be able to develop the IR approach and to boost the measurement of connectivity. So, once these pre-conditions are guaranteed, the focus can be shifted to the possible models of measuring connectivity level.

3.3.1 Measurement according to IIRC Framework

The IIRC does not introduce clear different levels of connectivity, instead it focuses the attention on the fact that the connectivity is reached or not in the Integrated report, and as a consequence it provides some helpful tools and ideas to let the companies achieve the best possible level of connectivity. Strictly related to the previous section, in the framework the IIRC has emphasized the relevance of digital communication. In a world which is characterized by a high level of uncertainty and continuous changes, the forms of communicating the new data should be updated. For this reason, the regulatory body 191 promotes some tools 192 through which the communication could be favoured and, at the same time, the connectivity enhanced:

1. “Digital reporting platforms”: according to the IIRC the reporting platforms could be considered extremely helpful if they are well managed by the IT department and if their design is user-friendly. They

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could become a huge data-storage where the audience can easily find the information it is looking for. Moreover, the digital platforms allow the organizations to easily update the data, rising the timeliness of the reporting process. Furthermore, the digital platforms allow the company to develop “cross-references” and “drill-down capability”, meaning that in the same report there could be some specific links which could address the reader to a more detailed level of information, avoiding redundancies within the document and enforcing the conciseness of it.

2. “Feedback-loops”: they are digital devices which strongly support the communication between the company and its stakeholders. They consist of online questionnaires, email addresses, surveys or links. All these devices would result to be helpful both for the organization because it can clearly understand the stakeholders’ needs and for the stakeholders, because they would have the opportunity to let the firm know which are the aspects that they value the most, providing trustable feedback.

3. “IR customization”: it is extremely important to provide the customers with readable and understandable information otherwise the risk of misunderstandings could lead the company in decreasing its reputation; for this reason the information disclosure process should be customized. Knowing that the audience to which the report is addressed is quite broad, the organizations should be careful in identifying the best way of communicating data for each audience group. In this context, the language is extremely relevant, because not all the readers would have the same level of knowledge, and for this reason a “glossary” could be useful; visual representations of data, such as graphs, should be introduced as well as icons and links which direct the reader to other specific contents, once again.

4. “XBRL language”: is the acronym for “eXtensible Business Reporting Language”, which is an “electronic communication language”. It allows the companies to have all the data codified, connected each other and updated, simplifying the process of finding information, and allowing the audience to be able to search for data in a very systematic way. In this context, storing the information with a systematic method supports the communication process both from an internal point of view, because all
the internal users would align their communication language, and from an external point of view, because the external stakeholders would be provided with timely data.

So, according to the IIRC, the connectivity of information depends so much on the development status of the communication process that it has provided some suggestions in order to help the organizations to clearly understand how to create linkages between data, using the modern technology, which is essential in the digitalization era.

However, if some guidelines should have been provided to the companies on how to effectively measure the level of connectivity, the procedure is not well defined, and it seems that the regulatory body is pushing for the connectivity measurements without posing solid basis for that; as a consequence, the majority of companies is in trouble in identifying the different levels of connectivity and in establishing at which level they are.

3.3.2 Measurement according to the “One Report” Concept

The first model proposed has been defined “One Report\textsuperscript{193}”, and it has been introduced by the authors Eccles and Krzus. It is interesting to notice the incipit of their book: “Many G-20 leaders have recognized the threats posed to our society and prosperity by climate change, depletion of finite natural resources, and related issue...current financial and sustainability reporting do not provide the necessary information to address these environmental or social challenges\textsuperscript{194}”; it is quite clear from their statement that in our society there are relevant issues that have to be tackled, however, the existing reporting processes are not able to provide a proper solution. At this point, they have provided the reader with their answer: the “One Report”. This model has been described as “a report that combines financial and narrative information found in a company’s Annual Report with the non-financial and narrative information found in a company’s Sustainability report”. From this perspective it could be possible to misunderstand the authors’ idea, simply interpreting the “One Report” as a mixture of both financial data and non-financial ones, however, with their concept they want to emphasize two different perspectives: on one hand, the report has to be a “single document” through which the company “is communicating to all stakeholders that it is taking a holistic view of their interests”, so, the report should accomplish its

main goal which consists in providing trustable information to the stakeholders, while on the other hand, the document has to “report financial and non-financial information in such a way that show their impacts on each other”, meaning that the data should not be simply combined together and disclosed, but they should be presented in a way that helps the reader to clearly identify the correlation among data, the cause-effect relationship and their influence on each other. According to this model, the connectivity is at its early stage; the authors only want to emphasize once again the necessity to link the financial part to the pre-financial one, however, they do not present a valid scheme that organizations could follow to effectively measure the connectivity among the internal different elements, so it would be better to consider this model helpful because it definitely supports the integrated reporting process, but also useless because, for the scope of this chapter, it does not add any kind of effective tool which indicates the possible level of connectivity.

3.3.3 Measurement according to Paternostro S.

A more interesting perspective has been developed by another author, Paternostro, who has provided the audience with a more efficient method to measure the connectivity level. According to the author, before moving to the analysis of the connectivity’s level it would be useful to focus the reader’s attention on the several information which the organizations usually disclose to the market, such as the financial statements, social and environmental results, firms’ management perspective and data about the used capital, both in economic terms and in intellectual one. All these pieces of information are in some way published in different reports provided by the company, and according to the author, it is possible to establish three different levels of connectivity on the basis of how much these data are linked each others:

1. The first level of connectivity is characterized by a “weak aggregation”; it implies that the data are communicated to the audience but not in a cohesive manner. The result is that the information is for sure provided to the stakeholders, however, correlation among data does not exist, and as a consequence, obtaining an holistic picture seems to be more difficult for the audience, even if it possesses all the required information. The data are not

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aggregated, and in this case, the level of connectivity within the report will results to be very low.

2. The second level of connectivity could be described through a “strong aggregation” among data. In this case, the information provided is combined to create a broader view of the organization, which helps the stakeholders. However, the final result cannot be defined as a proper Integrated Report, because all the cause-effects relationships are not yet emphasized. In this context, the organizations’ output are highlighted but, the ultimate outcomes to which the interrelations could lead are not underlined. In this context, it is possible to identify a medium level of connectivity among data.

3. In the last case, it would be possible to define the level of connectivity as the highest one. The reason lies in the fact that the data used so far, are not reported into the Integrated Report, but, they are analyzed and combined to generate new information, and those pieces of information would be later disclosed into the Integrated Report. It could be difficult to perceive, but, the highest level of connectivity is not given by the collage of all the previous data, but it would be generated by a new flow of information, originated by the combination of the former data.

According to Paternostro, the highest level should be the desired one by all the organizations, even if, it requires high ability of both re-interpreting information and synthesizing it to create a completely new set of data.

### 3.3.4 Measurement according to the Future-Fit Business Benchmark

A real innovative method has been presented by Future Fit-Business Benchmark\(^{197}\), a completely new society, which is still unknown for the majority of the global organizations but which is already considered as inspiring by few companies leader in the CSR. In its website, the organization describes itself through a very impactful statement: “A Future-Fit® society will protect the possibility that humans and other life can flourish on Earth forever, by being environmentally restorative, socially just and economically inclusive”. From its introduction, it appears quite clear their ultimate goal, which is however expressed in a total different way from other organizations: it is adopting really meaningful words such as “humans can flourish”,

\(^{197}\) Future-Fit Business Benchmark website, home page, http://futurefitbusiness.org/what-is-future-fitness/
“environmentally restorative” and “economically inclusive”. The selected words instil a strong sense of responsibility in the reader, who is more motivated to act in favour of social and environmental issues, and this fact means a lot, especially in an environment where the social and environmental issues are not perceived as relevant. Moreover, the Future-Fit expresses in an even more clear way its future goal, which consists of providing the organizations with the necessary capacities and tool to support “basic needs of billions of people around the world that are not being met”, to prevent companies from “disrupting and degrading Earth’s natural processes” and to support the “business in addressing these critical challenges”; the Future-Fit has perceived that everything is correlated on Earth, and that all the organizations could be perceived as part of a bigger system, and each of them has to put efforts in order to continuously allow the system to work at its best.

For this reason, Future-Fit has provided some few really helpful guidelines and practical tools to assess each performance within the firm, and as a consequence to guarantee the availability of only material information in a very concise way. In fact, it has identified only 23 “Action Guides”, which every firm can simply download from the website and use as starting point for the performance’s evaluation.

<table>
<thead>
<tr>
<th>Action Guide</th>
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<tbody>
<tr>
<td>FF01 Energy is from renewable resources</td>
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<tr>
<td>FF02 Water use is environmentally responsible and socially equitable</td>
</tr>
<tr>
<td>FF03 Natural resources are managed to respect the welfare of ecosystems, people and animals</td>
</tr>
<tr>
<td>FF04 Procurement safeguards the pursuit of future-fitness</td>
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<tr>
<td>FF05 Operational emissions do not harm people or the environment</td>
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<tr>
<td>FF06 Operations emit no greenhouse gases</td>
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<tr>
<td>FF07 Operational waste is eliminated</td>
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<tr>
<td>FF08 Operations do not encroach on ecosystems or communities</td>
</tr>
<tr>
<td>FF09 Community health is safeguarded</td>
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<tr>
<td>FF10 Employee health is safeguarded</td>
</tr>
<tr>
<td>FF11 Employees are paid at least a living wage</td>
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</tbody>
</table>
Employees are subject to fair employment terms

Employees are not subject to discrimination

Employee concerns are actively solicited, impartially judged and transparently addressed

Product communications are honest, ethical, and promote responsible use

Product concerns are actively solicited, impartially judged and transparently addressed

Products do not harm people or the environment

Products emit no greenhouse gases

Products can be repurposed

Business is conducted ethically

The right tax is paid in the right place at the right time

Lobbying and corporate influence safeguard the pursuit of future-fitness

Financial assets safeguard the pursuit of future-fitness

Table 5- Action Guides Future-Fit Business Benchmarks\textsuperscript{198}

It is clear from the table that the organization is providing a very innovative tool, which allows all the users to run a complete analysis of how they are operating with respect to both social and environmental issues, identifying the resources or capitals adopted, how they are transformed into values for the whole society and how they could be reused. Once the organizations has completed the assessment process, it should possess a quite large amount of really useful information, which could be disclosed into the Integrated Report.

In this context, the connectivity measurement should be introduced. As a matter of fact, completing the process by responding to all the questions would be extremely helpful for the organizations in order to capture at which level they are in operating in a sustainable way. So, the companies which would adopt this tool would benefit in terms of comprehension of how they are performing, and being aware of it would led them in understanding their level of connectivity and improving it. It has to be said that a very small numbers of companies are trying to use the Future-Fit Business Benchmark in their routine, because either the majority does not know that it has provided very

\textsuperscript{198} Future-Fit Business Benchmark website, http://futurefitbusiness.org/resources/downloads/
innovative and easy-to-use guidelines, and for the few which are using it, communicating the relevance of the tools and how their usage could bring advantage to the firm as a whole, seems to be a really tough process.

As a consequence, the possibility of measuring the connectivity level exists, however the companies seem to be unwilling to pursue this goal.

3.4 Real Case: Novo Nordisk A/S

Novo Nordisk is a Danish healthcare company, which could be considered the global leader in the diabetes care. At European level, it could be an example for its innovative approach to corporate reporting, in fact it has taken part in the Pilot Program launched by IIRC, and it has obtained very successful results so far. Its latest report, the one of 2017, is still called Annual Report, even if the contents are more aligned with the Integrated Report than with the traditional annual report, due to the disclosure of non-financial information both in quantitative terms, thanks to the social & environmental statements, and in qualitative terms, due to the narrative form of future outlook. For this reason, the Novo Nordisk Annual Report has been taken as example to both better comprehend what is connectivity and to evaluate the different levels which a company could achieve.

Since it has been already specified how could be difficult for the organizations to establish connections and interdependencies among all the acquired data, the analysis of this company could be helpful for the reader to understand how it is possible to define existing correlations. The analysis would be run on the basis of the IIRC guidelines, which indicate that the first level of connectivity should be established between the Content Elements(CE) and the six Capitals. In the connectivity framework provided by the IIRC, an easy tool (table) is provided:

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Considering the above mentioned table, it would be possible for the reader to understand how Novo Nordisk has been able to show the same connections suggested by the IIRC. In its latest Annual Report\(^2\), the company has reported its Business model, identifying in details which Capitals have been used for each part of the business model:

1. Inputs: the company has specified both the external and the internal inputs adopted as resources: “capital provided by investors”, “internal financial resources to invest in R&D”, “expertise from academic”, “internal manufacturing facilities”, “water, energy” and “skilled workforce”. It is quite clear that several capitals have been taken into account as primary resources for the organization, especially the Financial, Manufactured, Intellectual, Human and Natural Capitals.

2. Business activities: Novo Nordisk has then described its essential activities performed, which implies “engineering, formulating, developing and delivering protein-based treatment”, “efficient large-scale production”, “global commercial reach and leader in chronic disease care” and “deep disease understanding”. Even in this case, the business model structure is connected to the Capitals used during the activities, for example the first three activities

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could be grouped under the Manufactured and Human Capitals while the last one is more related to the Social & Relationship Capital.

3. Output & Outcomes: the products created by the company constitute its final output, while the outcomes ultimately generated are several such as “improved health and quality life for people with diabetes”, “job creation”, “contributions to communities”, “tax contributions” and “capacity and competence building”. In this perspective, the outcomes are connected both to the Capitals and to the value creation process.

At this first stage, the company has been able to establish a first level of connectivity between how it has adopted the capital as resources (inputs of Business model), how the capitals have been transformed into final products (business activities & output of Business model) and how the final products have had a positive impact on the society (Capitals, outcomes & value creation process). Moreover, the business model represents the strategy of the organization, which implies that its Governance is strongly striving for it. Coming back at the table reported by the IIRC, it’s now more clear how Novo Nordisk has accomplished its first level of connectivity, relating the Governance to the Business model to the Capitals and to the final Value creation. A similar analysis could be conducted highlighting different areas and taking into account also further levels of connectivity such as “past, present and future connections” and the connectivity between “qualitative and quantitative data”.

<table>
<thead>
<tr>
<th>Value creation</th>
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<tr>
<td>Capitals</td>
</tr>
<tr>
<td>Organizational overview &amp; External environment(CE)</td>
</tr>
<tr>
<td>Governance(CE)</td>
</tr>
<tr>
<td>Opportunities &amp; Risk(CE)</td>
</tr>
<tr>
<td>Strategy &amp; Resource allocation(CE)</td>
</tr>
<tr>
<td>Business Model(CE)</td>
</tr>
<tr>
<td>Performance(CE)</td>
</tr>
<tr>
<td>Future Outlook(CE)</td>
</tr>
</tbody>
</table>

Table 7 - Connectivity Diagram & Temporal Connections
In this case it would be better to consider the organization’s performance, which consists of past and present data of both qualitative and quantitative types, in relation to both another component of the Business model, the Future outlook, which represents the future perspective, and the Capitals. To provide a complete example, the connections would be highlighted in different parts:

1. Financial performance: before introducing the complete description of connections, it would be better to remember that the financial performance could be related to the Capitals because it reflects the capability of the firm to generate profit, which is the first output from the value creation process. Having stated that, Novo Nordisk has provided its current financial performances\textsuperscript{201} in relation to two years back, meaning that the company has connected the current quantitative results to the past quantitative features, raising the level of connectivity. Moreover, the current financial performance is considered as the starting point for the future financial results (future outlook), which implies once again, a further connections in terms of time-perspective (the current results would influence the future ones). As a matter of fact, in the Annual Report, a financial outlook is provided, emphasizing mainly the “sales growth”, “operating profit growth” and the “free cash flow”\textsuperscript{202}. So in synthesis, two levels of connectivity are shown:
   i. Connectivity between capitals and performance so between Content Elements and Capitals
   ii. Connectivity between past, present and future data and Content Elements

2. Non financial performance: in this case the company has provided data about both its social and its environmental current results (once again the results are the consequence of the usage of Capitals), comparing these performances with the past results such as “animal purchased for research” for the past years 2015, 2016 or “water consumption” for the same two past years. In a similar way as for the financial Future outlook, these qualitative data are considered as the

\textsuperscript{201}Novo Nordisk website, “Annual Report 2017”, p. 58
\textsuperscript{202}Novo Nordisk website, “Annual Report 2017”, p. 8
starting point for future qualitative targets (future non financial outlook), such as “reduction in animal used” and “reduction of water usage”. In this context two interdependencies are highlighted:

i. Connectivity between Capitals and non financial performance, so between Capitals and Content Element

ii. Connectivity between past, present and future data and Content Element

3. Non financial performance: in this context, the connection is established between past & current non financial data and future outlook as already emphasized, but the focus should be on the fact that the current qualitative data would influence the future quantitative data. As a matter of fact, in the environmental statement a current qualitative feature is provided: “share of renewable power for production”, and in this qualitative feature would affect the financial future outlook because the company has stated that by 2020 it would used only 100% renewable energy, implying that the qualitative measure will have a strong impact on the future financial feature of “energy costs”, reducing them. So, in this case the levels of connectivity are three:

i. Connectivity between Capitals and Content Element

ii. Connectivity between past, present and future data and Content Element

iii. Connectivity between qualitative current Content Element and quantitative future Content Element

So due to the above mentioned paragraph it is possible to state that the company has been able to reach at least three levels of connectivity: the connectivity of Content Elements, of Past, Present & Future information and of Capitals. Even if at first glance the IIRC guidelines appear quite complex and not so clear to put into practice, the reality is that all organizations have already established several connections and interdependencies when they build their business model, strategy and outlook, because to do so they have to clearly understand which resources are they using and which

market they are operating in, what they want to achieve and how; this implies that the real need consists of simply being aware of which are the connections among different parts behind their strategy and try to disclose these interconnections once brought to light.

The last type of connectivity consists of the alignment between information disclosed internally and data published to the external stakeholders, and more in detail, from an internal point of view, whether the data are shared between all the hierarchical levels within the organization. In this case, it would be a little more difficult for the external audience to perceive whether the data reported externally are shared within the different departments in the organization and how much each department is aware of a specific information, however, the certain fact is that the information disclosed in the Annual Report has been approved by the organization’s executives, meaning that the data are aligned with the ultimate firm’s strategy.

As conclusion, it would be better to recall that on one hand providing such a high level of non-financial information disclosure requires the company to invest a lot in its internal workforce skills and in the overall process of transforming the Annual Report in a more integrated one; resources which not all the companies can have at their disposal. On the other hand, always it has to be considered that the integration of non financial information is still not mandatory for the small and medium organizations, fact that does not motivate them in improving their reporting processes.

3.5 Existing Challenges and Future Development

Providing a tool to efficiently measure the level of information connectivity seems to be a real huge issue for the next future. Especially in a context where all the data are continuously in transformation, establishing existing correlations among them is a real tough process to face with, and moreover, it seems that no valid models to measure connectivity exist. The guidelines provided by the IIRC are not so clear, and they do not specify a connectivity scale; they are quite general about what connectivity is, leaving huge space for companies’ interpretation, which could have been considered a good starting point if all the organizations were at a very high-quality level of information reporting, but they are not, so the discretion and the freedom of choosing which type of connectivity fits better, has become a disadvantage.

Some authors have provided basic models through which organizations could at least start their connectivity evaluation, but these models are still incomplete or too
complex in comparison with the real skills shown by the organizational users; the literature about information connectivity is at its early stage if compared to the huge amount of academic papers drawn up for the <IR> in general. The academic research about connectivity seems to be not so willing to drill down this field, mainly because connectivity is strongly characterized by uncertainty and it could appear to be really difficult setting fix standards and rules for an uncertain subject.

However, as it has been proved, the Future-Fit Business Benchmark has provided some very easy guidelines which could be followed and lead to a better comprehension of what connectivity means, at least. Unfortunately, in this context, the maturity level of companies about reporting process and the perception that they have about how would be the future in information disclosure affects their adoption a lot, and it appears that the majority of companies is not able to seize this opportunity.

Nevertheless, creating a sort of plan which the organizations could follow to analyze how much they value connectivity within their business is possible, and it is shown by an interesting figure called “Connectivity Matrix”, provided by Andalf Journal. In the matrix vertical axis the six capitals are reported, while in the horizontal axis, the organization’s goals and the relative KPIs are described. The companies have to identify which capitals are adopted for each goal and whether the KPIs have been taken into account to evaluate their performance. In this context, the tool provides a complete picture about which resources have been used to reach specific objectives, and whether and how the capitals have been combined to reach same goals, so, as a consequence, the company would be able to evaluate at least the connectivity among capitals, and between financial and non financial resources, because once the matrix has been completed, the firm would know exactly the processes from which it can extract both financial and non-financial information. However, the connectivity evaluation is not complete, since the correlation between past-present-future plans is not taken into consideration as it is not the alignment between internal and external information communication. So, the tool could be really helpful for the first stage of analysis but it needs to be supported by additional tools.

A reasonable suggestion for future applications is to focus on this field, trying to provide the organizations with useful tools, even if the core issue remains the same: since the Integrated Reporting process is not mandatory, the companies are not

motivated in investing in measuring connectivity and not even in comprehending it, creating a gap between what the IIRC’s future desired goal is and how the companies are trying to reach it.
4 Assurance

In this chapter the Assurance issue is going to be analyzed. Before moving to the complete description of how the assurance should be provided to the Integrated Report, it would be better to remember that there exist two different types of Assurance: the external one, which is provided by audit firms, and the internal one, which is run by the organization itself. Both the types will be presented in details in order to comprehend whether the information would be guaranteed.

4.1 External Assurance

To really capture the relevance of the assurance issue in relation to the Integrated Report’s development, it would be better to consider, as a starting point, a statement provided by Miller and Proctor, who have stated: “if the future of integrated reporting is standardization, that standardization will likely require external assurance”\(^\text{206}\). Clearly the authors have summarized in few words the fundamental need related to the development of IR: the non financial information assurance.

In this context, it would be better to remember that the financial data must be ensured, in order to not be liable from a legal point of view. As a matter of fact, the “INTERNATIONAL STANDARD ON REVIEW ENGAGEMENTS 2400” specifies which duties the “practitioners” have to follow during the review of the financial statements: “The practitioner should comply with the Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants (the IESBA Code). Ethical principles governing the practitioner’s professional responsibilities are: (a) Independence; (b) Integrity; (c) Objectivity; (d) Professional competence and due care; (e) Confidentiality; (f) Professional behaviour; and (g) Technical standards”. All the duties above reported, have been identified in order to ensure that all the experts involved in any review process of financial information, are free from biases as much as possible, enhancing the level of credibility and trust-ability of data, which would be essential for any type of investment decision. In the same document, it is also indicated the ultimate objective of the professionals’ role: “The objective of a review of financial statements is to enable a practitioner to state whether, on the basis of procedures which do not provide all the evidence that would be required


\(^{207}\) ISRE 2400 (2006), “ENGAGEMENTS TO REVIEW FINANCIAL STATEMENTS”, p. 231
in an audit, anything has come to the practitioner’s attention that causes the practitioner to believe that the financial statements are not prepared, in all material respects, in accordance with the applicable financial reporting framework (negative assurance).  

As a consequence, it appears quite clear that the financial statements have to be both prepared according to the international frameworks, and reviewed by designed experts, who have the legal duty to guarantee all the numerical data. As a matter of fact, the Annual Report presents a very high level of assurance, especially external one, enhancing its reliability.

The Integrated Report is not currently demonstrating the same level of non financial information assurance, actually the guarantee level on non financial information is extremely low. This low level of information reliability does not mean that the assurance is not necessary, it only implies that the process to obtain assurance on environmental and social data is perceived to be long and complex. If on one hand, the level of transparency about firms’ activities has been increased, due to the disclosure of non financial data, on the other hand, the level of trust-ability on these activities has not, as it is emphasized by Dando and Swift in their paper: “it seems that greater transparency is not enough to engender trust and cannot be said to equate to more effective accountability”. As a consequence, the assurance of non financial data could be considered, together with the materiality one, the most urgent issue to be solved in the next years, otherwise, there exists the risk that the IR could remain the “new report” only in theory; following this reasoning, the Association of Chartered Certified Accountants has been mentioned in several papers: “as Integrated Reporting becomes more valued for decisions on investments, the priority placed on independent assurance will necessarily increase”, and especially: “all organizations want to show themselves in the best possible light. ACCA believes that independent external assurance is a vital part of the credibility and trust building process.”

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208 ISRE 2400 (2006), “ENGAGEMENTS TO REVIEW FINANCIAL STATEMENTS”, p. 231
So, enhancing the credibility and the trust-ability of the report, is only one of the reasons behind the need to guarantee non financial data; in the following part, all the other reasons which require the assurance, are going to be analyzed.

The first cause for which the assurance of non financial information should be developed at international level is the standardization. From the previous chapter, it is possible to know that the IIRC has established an international framework useful during the preparation of the report, however, as it has been already specified, the guidelines and principles provided are not mandatory, with the consequence that each company is free to report those contents that could be useful to enhance its credibility level and its reputation with respect to the market. As a consequence, so far the Integrated Reporting could not be considered as a proper reporting method due to the fact that, when it is compared with the Annual Report, it presents lack of standardization and comparability among firms, and as stated, lack of assurance. One way to drive the Integrated Report at the same level of the Annual Report, increasing the adoption of the former, would consist of filling the gaps above stated, starting by the assurance. Guaranteeing the firms’ environmental and social performances through assurance, would encourage the standardization of the reporting practice. The idea has been supported by IIRC, which has in some ways: “attempted to provide some level of standardization for external assurance”\(^\text{212}\).

Another consequence that inherently could be generated by the assurance is the improvement of internal management decision. From a theoretical perspective, as it was already stated in the first part, the assurance of financial information is provided mainly because it generates a positive reaction on the market and on the potential investors; Healy and Palepu have stated: “Research shows that capital providers require firms to hire an independent auditor as a condition of financing, even when it is not required by regulation...This implies that capital providers regard auditors as enhancing credibility”\(^\text{213}\)” to support that theory. In the case of non-financial information, the external benefits that would be generated by the assurance are quite similar to those created by the financial information guarantee: the ultimate goal consists of obtaining investments.


On the other hand, the internal advantages that organizations could gain by providing assurance are not always mentioned. First of all, if companies are aware that their data will be controlled before the public disclosure, the internal auditors would focus more attention on the details and on the type of information chosen. The firm as a whole would feel more under pressure due to the external monitoring of non financial data, with the direct consequence of improving the quality of information provided. Secondly, if the assurance on pre financial data is provided, the internal auditors of the organization would be trained in order to acquire new skills and competencies that would be necessary to face with the assurance of IR, in fact: “multi-disciplinary teams are needed to engage with and review very different types of information in order to provide a succinct account of how a business manages strategy, risk and financial and non financial resources in the short-and long-term. Finally, knowing that the assurance would be guaranteed, implies a better and complete comprehension of the resources adopted by the firm, with the subsequent attention to how the capitals, and the relative qualitative information, could be better described in a quantitative way and monetized: “the emphasis is on understanding and explaining a complex and subjective business state and ensuring – not by eliminating difficult-to-quantify information – but by providing a detailed account and documenting how conclusions are being reached.”

To summarize, the development of the Integrated Report is into close contact with the provision of assurance for non-financial information, otherwise, the effectiveness of the new reporting process could be null. In the following sections, the external assurance that should be needed for both social and environmental data, is described in details, highlighting the lacks that the IR’s assurance shows with respect to the Annual Report’s one.

4.1.1 Comparison between Financial Information Assurance and Non Financial Information Assurance

Before explaining how the external assurance should be provided by the professionals, it would be better to compare the assurance of IR with the one already provided to the Annual Report, in order to capture the major differences which could become hints for a future development of the IR’s assurance. Cohen and Simnett have

\footnote{Maroun W. (2018), “Modifying assurance practices to meet the needs of integrated reporting”, p.406, Accounting, Auditing & Accountability Journal}

\footnote{Maroun W. (2018), “Modifying assurance practices to meet the needs of integrated reporting”, p.406, Accounting, Auditing & Accountability Journal}
reported a complete comparison in their academic paper “CSR and Assurance Services: A Research Agenda”, which is at the basis for this section. The main differences identified by the two authors are four and are illustrated below:

1. “The existence of a competitive market”; in the case of financial information, it is well-known that there exist few global audit firms which ensure the financial statement, meaning that all the listed organizations have to choose among these four accounting firms (the Big Four). As a matter of fact, there is not a strong competition in the assurance market for financial data, due to the fact that all the market opportunities are grasped by these auditing giants. In the case of pre-financial information, the scenario is completely different, due to the fact that each colossus of the Big Four is currently developing principles and standards to ensure non financial information; this implies that the external assurance for social and environmental data is not already managed and completely controlled by the Big Four, and consequently, the existing opportunities could be seized by other types of service providers. To explain the difference, the authors have stated: “unlike the audits of financial statements, the accounting profession does not have a monopoly on assurance services related to CSR so audit firms must compete with other types of service providers”; from the statement it is quite clear what “existence of competitive market” is meaning.

2. “The diversity of subject matter examined”; in the context of financial statements, the external auditors know exactly what they have to check, how the numerical data should look like and which are the main international mandatory standards that they have to respect. In the case of IR, the information disclosed consists of a huge variety of contents, with the description of capitals which can be expressed better in a narrative way rather than in a quantitative one. As a consequence, on one hand it rises the necessity to develop new guidelines according to which evaluate the pre-financial data; on the other hand, it appears to be clear that the “analysis included in an integrated report was regarded as being too

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217 The Big Four are the largest accounting firms in the world. The group is composed by Deloitte, PwC, EY and KPMG. Each firm gains a huge market share, impeding new entrants in the market.
subjective to form the basis of a reasonable or limited assurance\textsuperscript{218}, which creates a difficult obstacle to overcome, because the subjectivity of the non-financial data cannot be assessed through a methodological and scientific way, meaning that, so far the external auditors can only provide some opinions about the subjective contents and nothing more. Moreover, the diversity of the contents requires the external auditors to develop new competencies related to both social and environmental issues, and, the training of auditors could result to be a complex process due to the recent features of IR and the huge quantity of researches just started.

3. “The lack of analytic rigor that arises in double-entry system”; as already stated, the financial statements are prepared according to rigid standards approved by several legal jurisdictions, implying that the firms could be legally liable if they provide false information. As a consequence, when the auditors have checked whether the accounts are trustable, their job is done. In the case of voluntary information, assuring the data is a tough process because there is not a “double-entry system” through which is possible to compare the credibility of information. In his paper, Maroun W. reported an auditor’s comment about this lack of analytical approach: “You ask me to look at a company’s strategy and its key risks which they talk about in their integrated report...The best I can do is tell you that the statements in the report cross-reference to what was discussed in the Board meetings and that the risks in the report are also in the risk register...what you really want to know is if the strategy is the right one and if all the risks are complete but no one can tell you that”. The comment is complete, the auditors do not have the possibility to compare the firms’ data with others.

4. “The relative lack of well-developed criteria”; in the IR context, the international body IIRC has provided some guidelines that the organization could decide to follow. The principles are not mandatory, the process through which the IR is prepared is not mandatory, the data assurance is not legally required. The only way to solve the assurance

\textsuperscript{218} Maroun W. (2018), “Modifying assurance practices to meet the needs of integrated reporting”, p.410, Accounting, Auditing & Accountability Journal
issue is to develop well-established criteria, transforming the social and environmental data in mandatory disclosed information. For this reason, in the following section an analysis about the existing criteria adopted is run.

4.2 Auditors’ Role and the Guidelines

In this section the role of the major players in the assurance market, is going to be analyzed: the auditors’ role. In the same way, the guidelines which are currently adopted by the auditors will be described in order to comprehend how the auditors are supported from already established standards.

4.2.1 Auditors’ Role

First of all, it would be better to highlight the characteristics that an auditor in general should possess in order to perform his/her job at the best: “to enhance the assurance, it is important that the assurer is someone who is independent of the reporting entity, has a sufficient understanding and expertise concerning the various ways of measuring and reporting information, is trained and proficient in assurance and evidence-gathering techniques, and has sufficient quality controls over the process”.

Assuming that the auditor has all the above mentioned qualities and capabilities, the focus could be shifted on how the companies choose their auditors. The auditor’s selection process, from the organization’s point of view, is determined by two approaches: the “economic rationality” and the “collective rationality”. On one hand, the company that wants to ensure its non-financial data could choose its auditors on the basis of the “cost-benefit analysis”, implying that there would be a higher probability that the companies will hire the auditors for ensuring firstly financial data and then non-financial ones. In this case, the advantages are given both to the company and to the auditors; in fact, the organization could reduce the costs of accounting due to the use of some common auditing processes, while the auditors can benefit from the “knowledge acquired during the financial audit process”. According to the “collective rationality” approach, the company could select the auditors on the basis of its own reputation and the auditor’s one; or it could choose the assurer on the basis of “social pressure”,

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coming from both the country and industry in which the company operates. The “collective rationality” represents what the authors Briem and Wald defined as “Institutional isomorphism”. The authors supported the thesis that the organizations are driven to apply assurance on their data due to three main reasons:

1. “Coercive isomorphism” which is described as “external pressure that are set up directly or indirectly by organizations on which the company is dependent, or by cultural expectations”;
2. “Mimetic isomorphism”, that occurs when the environment in which organizations operate is extremely uncertain, and as a consequence, “imitating other organizations becomes a legitimate way to proceed”;
3. “Normative isomorphism” that could be depicted as a manner used by the professionals such as consultants and committee groups, that adopt “similar approach to problem solving”, due to their similar educational background.

All these three perspectives influence the companies in the auditors’ selection process, emphasizing the non-rational behaviour instead of the economic one.

Once the auditors have been selected, they could decide how to proceed with the assessment of data. Fernandez-Feijoo et al. believed that the majority of auditing firms “does not behave uniformly at global level”, meaning that it adopts an “adaptation strategy”, so it behaves and processes data taking into account both the country, and its relative legal jurisdiction, and the industry with the relative competitors. The same idea is better expressed in another academic paper where it is stated: “there is no uniform procedure to assure an integrated report. The vague legal situation and the inconsistent definition of the report itself are reasons for the different assurance procedures”. The auditors’ role could be considered as a really tough task, due to the fact that the professionals can decide how to evaluate the non financial information: on the basis of its quantity, or on the basis of the quality and derivation of that kind of information. The possibility of choosing the procedure to assess data makes the whole process not objective, hence, the assurance provided could result to be subjective. Moreover, the

majority of the Integrated Report includes forward-looking information, and that type of data cannot be evaluated by the auditors, in fact “they are not able and not allowed to assure non-predictable information”, as Briem and Wald have suggested. The same point of view is expressed by Maroun and Atkins, who have summarized the topics which can be/ can’t be guaranteed by the assurers in a table:

<table>
<thead>
<tr>
<th>What can be assured?</th>
<th>What cannot be assured?</th>
</tr>
</thead>
<tbody>
<tr>
<td>✔ Financial statements</td>
<td>– Forward-looking approach</td>
</tr>
<tr>
<td>✔ Quantitative corporate governance information</td>
<td>– Strategy section, including key performance indicators</td>
</tr>
<tr>
<td>✔ Fatalities</td>
<td>– Integrated thinking underlying the reports</td>
</tr>
<tr>
<td>✔ Client’s order books</td>
<td>– Qualitative corporate governance information</td>
</tr>
<tr>
<td>✔ Safety statistics</td>
<td>– Management views on risk</td>
</tr>
<tr>
<td>✔ Carbon emissions</td>
<td>– Management views on direction of the company or any management interpretation</td>
</tr>
<tr>
<td>✔ Reconciliation of the opening and closing number of employees at a company</td>
<td>– The adequacy of triple bottom line reporting</td>
</tr>
<tr>
<td>✔ Water usage</td>
<td>– Sustainability and corporate social responsibility narrative</td>
</tr>
<tr>
<td>✔ Water resources</td>
<td>– Company’s corporate mission</td>
</tr>
</tbody>
</table>

Table 8- Elements of IR that can and cannot be assured

So, what the external accounting professionals can currently do consists of providing two types of assurance: “limited assurance” and “reasonable assurance”, both described in Briem’s paper. In the first case, the assurers feel comfortable in confirming that the IR is prepared according to the guidelines provided by the IIRC’s Framework; in the other case, the professionals should confirm that all the data reported are “correct”, meaning that the auditors would be responsible for all the information. It would appear quite clear that the majority of auditors would opt for the “limited assurance”, in order to not be liable from legal point of view.

4.2.2 Existing Guidelines and Standards

Once the auditors’ role has been explained, it would be better to focus the attention on the guidelines that currently they can follow, in order to provide a basic form of assurance to pre-financial data.

4.2.2.1 ISAE3000

The IIRC in its paper “Assurance on <IR>, an exploration of issue” has stated: “the standard that stands out in the mind of many assurance practitioners as one that would be most fundamental to an assurance engagement regardless of whether performed by an accounting firm or another assurance practitioner is ISAE3000”.

ISAE stands for International Standard on Assurance Engagement, and in the paper it is possible to read that: “the purpose of this International Standard on Assurance Engagements (ISAE) is to establish basic principles and essential procedures for, and to provide guidance to, professional accountants in public practice for the performance of assurance engagements”.

The engagement clarifies the requirements that the professionals have to respect in order to guarantee information: all the practitioners have to comply with the “Code of Ethics for Professional Accountants”, which mainly consists of protecting and maintaining the independence of the accountants; the professionals who are part of an accounting firm have to ensure “a system of quality control” so that the users of guaranteed information could be sure that the accountants are “comply with professional standards and legal requirements”.

Once the practitioners have proved that all the requirements are satisfied, the engagement between the accounting part and the firm which needs assurance can be prepared. In this context, ISAE has specified that “to avoid misunderstandings, the agreed terms are recorded in an engagement letter or other suitable form of contract”. Once the contract between the parties have been signed, the practitioners could start with the analysis of the organization, both from an external point of view and from an internal one. On one hand, the accountants have to be aware of the industry’s characteristics where the firm operates, the potential risks related to both the market’s uncertainty and the business activities. From an internal point of view, the practitioners have to capture which are the needs of their clients, and which is the level of personnel knowledge and skills, in order to understand whether the materiality concept has been taken properly into account, and whether the misstatement risk is existing or not.

IIRC website (2014), “Assurance on <IR>, an exploration of issue”, p. 28
ISAE (2005), “ASSURANCE ENGAGEMENTS OTHER THAN AUDITS OR REVIEWS OF HISTORICAL FINANCIAL INFORMATION”, p.293
ISAE (2005), “ASSURANCE ENGAGEMENTS OTHER THAN AUDITS OR REVIEWS OF HISTORICAL FINANCIAL INFORMATION”, p.295
At this point the accountants have to provide their judgement on the basis of a “frame of reference” provided by ISAE, which can be summarized in few relevant points:

1. “Subject matter”, meaning that the professionals have to take care of which are the most important topics, with their relative characteristics, that the firm wants to assure;
2. “Suitability of criteria”; the accountants should be aware of which are the key performance indicators used to quantify/ describe the matters, in order to be able to evaluate whether they are appropriate or not, and whether there exists the necessity to develop new criteria;
3. “Materiality”; the practitioners have to run an analysis to establish whether the information collected so far is material and whether it could be assured;
4. “Obtaining evidence”; the professionals have to provide evidence in order to ensure fair and reliable data.

During all the stages of the process, the accountants could be supported by experts in different fields, in order to be sure that they are proceeding in the right way. When the process is almost completed, “the practitioner should conclude whether sufficient appropriate evidence has been obtained to support the conclusion expressed in the assurance report” and “the assurance report should be in writing and should contain a clear expression of the practitioner’s conclusion about the subject matter information”. The rest of the ISAE3000 document provides a detailed description of what an assurance report should include.

### 4.2.2.2 AA1000AS

Another principle followed by the accountants has been emphasized in another paper, where it is reported: “with regard to assurance standards, the prior literature identifies two widely accepted frameworks for assurance services: the first is the Assurance Standard AA1000AS launched in 2003 by AccountAbility...”. The AA1000AS launched in 2003, has been substituted by a new Assurance Standard,
created in 2008 by the same international body, AccountAbility regulatory body, and it has been named in a similar way: Assurance Standard 1000 Sustainability Assurance.

As the ISAE3000’s content and form have been described in the previous section, in this part the same analysis for the AA1000AS(2008) is going to be run.

First of all, it would be better to start by making explicit the aim of the principle: “Sustainability assurance in accordance with the AA1000AS (2008) evaluates and provides conclusions on: the quality of publicly disclosed information on sustainability performance\textsuperscript{231},” so the regulatory body itself is clarifying that the major purpose of the standard consists of providing an assessment on the information disclosed on “sustainability performance”, meaning that both the social and the environmental results will be taken into account. Following the AA1000AS structure, it is possible to capture that the document is addressed to a broad audience which includes: the practitioners, so the external accountants who have to provide assurance on the reports, the internal preparers of the reports, in order to help them in knowing what they have to disclose to obtain the external assurance, and the readers of the reports.

Also in this context, before proceeding with the assurance engagement, the practitioners have to adhere to some ethic assumptions such as:

1. Independence; the assurance providers have to guarantee that it does not exist any kind of relationship with the organization.
2. Impartiality; the providers have to ensure that they will follow all their professional codes in order to provide a fair and authentic assessment on the reports, both in case of positive results and in case of negative ones.
3. Competence; the practitioners have to be sure that they own the necessary skills and competencies to face with the assurance on sustainable information, otherwise they should refuse the engagement.
4. “Due care\textsuperscript{232}”; the assurance providers should keep in mind which are the organization’s needs and should comply with them.

Once the assurers have demonstrated that they possess all the necessary competencies to perform their tasks, the assurance engagement could be signed and the assurance process could be planned. According to the AA1000AS the engagement could be considered valid if: “the terms and conditions of the engagement shall be agreed in

\textsuperscript{231} AccountAbility (2008), “AA1000 Assurance Standard 2008”, p.8
\textsuperscript{232} AccountAbility (2008), “AA1000 Assurance Standard 2008”, p.16
writing”, otherwise no contract will exist between the auditing firm and the organization. The planning process consists of similar phases described by the ISAE3000, so in the first place the auditing firm should consider which results have to be publicly disclosed, in order to comprehend which tasks and activities lead to those final results, moreover the performances obtained should be material and relevant for stakeholders; than the auditors should establish the proper criteria to evaluate those results, criteria in accordance with their standards; at this point, the assurance providers have to gather evidence about the information, in order to prove it. Finally, the assurance report could be provided to the organization.

The above described principles (ISAE3000 and AA1000AS) are the standards mainly used by the organizations to ensure their sustainable data, implying that the IIRC Framework is supported and enhanced by other guidelines, which are considered more reliable from auditing firms’ point of view. It would be better to remember that, even if these standards could be apply in order to judge non-financial information, some important issues remain in this context. The problems are expressed by the auditors themselves in an interview run by Atkins and Maroun: “the end result is that you have different types of engagements covering different parts of the integrated report. That’s all well and good but don’t you think that people will be confused by all of this?” and again “the auditor can only assure what has been done. If he does anything more than that, he is giving an interpretation or projection and that ceases to be assurance”\(^\text{233}\). The two statements highlight the real evidence: on one hand, there is the willingness to provide auditing firms with guidelines to follow, however these guidelines are not mandatory and they do not allow a systematic process of information evaluation; on the other hand, some parts of the IR could be really ensured, but no more steps forward seem to be possible without generating the risk of providing subjective expectations.

4.3 Models of External Assurance

In the previous parts the external assurance has been described in details, particularly the lack of effective assurance, due to the lack of objectivity, has been emphasized. In the following section, some basic models proposed by Warren Maroun are going to be analyzed. The author’s purpose consists of improving the assurance process, providing some hints both to the practitioners and to the preparers of the

Integrated Report. The papers that will be mentioned are: “Assuring the Integrate report: Insights and recommendations from auditors and prepares”234 and “Modifying assurance practices to meet the needs of integrated reporting, the case for “interpretive assurance”235.

4.3.1 Restricted Assurance

The first model that the author has suggested was named “Restricted Assurance”, due to the extent to which the assurance is provided. To elaborate this first model, Maroun started by some interviews addressed to expert auditors; he has collected all their opinions and explained them through an explicit comment provided by an interviewed: “the IIRC’s framework is not specific on exactly what needs to be reported. All it says is that you need to explain how you create value...all of it is your opinion. It’s all about what you think and not about the facts”236. The statement is extremely clear: the auditor believes that an effective assurance cannot be possible because the majority of Integrated Report’s contents are projections and opinions about the firm’s future, which cannot be ensured systematically.

For this reason, Maroun has proposed a method that allows the auditors to be responsible only for verifiable information; so the author has stated: “the objective and the scope of any assurance engagement should be limited to expressing an opinion on the financial statements”. Taking into account only the financial information implies that the auditors adopt a systematic and mathematical method to evaluate data, which are collected and assessed from a completely objective point of view. The author seems to re-propose an old assurance method, where only the financial data can be guaranteed, and the assurance process is run only if the benefits of it exceeds the costs. The traditional perspective of assurance takes into account only financial information, looking mainly at the “financial returns” which are considered by the investors as “the primary indicator of corporate sustainability”. The auditors would support this model, because it does not imply any kind of improvement for their profession, any kind of extra efforts in evaluating pre-financial data or any kind of new skills to acquire. Another auditor has stated in an interview: “in the twenty years that I have been

235 Maroun W. (2018), “Modifying assurance practices to meet the needs of integrated reporting, the case for “interpretive assurance””, Accounting, Auditing & Accountability Journal
overseeing the annual - and now the integrated reports – and meeting with stakeholders, I have never been asked why the other information in the integrated report is not assured. The investors don’t ask for it...so why incur in extra cost?²³⁷“.

From this perspective, it is obvious that the auditors themselves are not encouraged to guarantee non-financial data if the investors do not ask for them. So, according to this point of view, all figures involved with the IR are caught in a cycle: the investors do not ask for assurance, as a consequence the auditors do not provide any guarantee, being legitimated by the model itself.

From a personal point of view, the Restricted assurance seems to be a comfortable method to protect the auditors’ role and interests, instead of improving the assurance’s quality. However, Maroun has studied also others models that are going to be introduced.

4.3.2 Integrated Assurance

The second model described by the author in his paper, seems to move slightly from the previous one, and it is called: “Integrated Assurance”. In this case, as opposite to the Restricted model, Maroun has shown his willingness to provide a better quality assurance model to the organizations which ask for it.

To introduce the model conveniently, it would be better to report the author’s words: “assurance is interpreted very broadly. It is not only derived from formal engagements...but also from the activities of internal audit, the integrity of underlying reporting system and the monitoring and review by senior management²³⁸”. According to the statement, the model is based not only on the “formal engagement”, so on the external assurance, but also on the internal one, focusing the attention on the internal activities of preparing and controlling the reporting process. According to Maroun, the assurance should not be provided only at the end of the process, when the IR is completed and the external auditors can only read the final data reported on it, but the assurance should be applied during the whole preparation process. This implies that the practitioners should monitor the complete process of drawing up the Integrated Report, controlling how activities are performed, how data are collected, processed and interpreted, which people are involved in the process. It is not only a matter of verifying

the data written in the report, it is about controlling the process which leads to the final Integrated Report.

To explain the concept, Maroun has stated: “testing the system used to prepare the integrated report would be more important than formal assurance engagements providing an opinion on specific report content”\(^{239}\), so the emphasis is on “testing the system”, which is at the basis of the ultimate IR.

Moreover, dealing with the whole process requires the auditors team to show “high level of expertise in different parts of the corporate reporting process”, meaning that the team should have capabilities of treating both financial and non-financial data, and skills related to the managerial part of activities. Once it has been said that the internal process of assurance is extremely important according to this model, it would be better to enlighten which figures are mainly involved with the process itself. As a matter of fact, the internal auditors are professionals who are fundamental for the assurance because they run the monitoring and controlling process ensuring that all the internal operations are performed properly; as well as the preparers are important to the drawing up phase of the Integrated Report; however, there are other figures which are extremely important even if their participation to the IR’s editing or checking phases is not so easy to notice, they are “those charged with governance”, who have to choose, before the IR’s writing, the information that would be publicly disclosed. Their role is probably the most relevant one due to their decision-making power at the basis of the IR.

4.3.3 Delphi-inspired Assurance

The third model proposed by Maroun, is a sort of evolution of the previous Integrated model of assurance. The author believes that the Integrated Assurance model could be perceived and adopted as a tool for internal control, meaning that, according to Maroun, all the organizations should implement their internal management control with this assurance model. As a consequence, if the Integrated Assurance model would be considered as an internal managerial tool, the formal assurance should be guaranteed by another system applied by the organizations.

In this context, the Delphi-inspired model has been theorized by Maroun, who has kept the original idea of evaluating and controlling the whole system of editing the IR,

instead of looking only at the final data, and he has improved, or better mixed, this idea with the traditional system of external assurance. So, according to the author, the internal preparers and the auditors have to write the Integrated Report, but, instead of controlling the process by themselves, performing both the preparing role and the monitoring one, they could “rely on a panel of independent experts to examine and conclude on the method followed to prepare the report and to provide users with an opinion on those processes\textsuperscript{240}”. So, Maroun has improved the previous model by introducing the “experts’ figures”, who would become responsible for the process’s monitoring phase. In some ways, it has been recognized the need of having a figure external to the firm which could ensure the system and, as a consequence, the data published, in a more transparent and objective way for the final users of the report. Maroun has reported an auditor’s comment on how the Delphi-inspired model would be useful from the organizational point of view: “it may be possible to tell people that you have looked at the system and the thought processes and that you have engaged with different people in the organization to get a sense of whether they have put any thought into the integrated report and are not just writing fairy tales”.

The Delphi-inspired model seems to be different from the previous one due to the necessity of involving external figures for the assurance practices of the IR, however, the author has emphasized also a drawback which cannot be forgot: the cost-benefit analysis. In the case of Delphi’s model, the costs in which the firms risk to fall are incredibly high, because the controlling procedures would be repeated at least twice: the first time for the Annual Report and the second time for the Integrated one. As a consequence, all the three models seem to have drawbacks which cannot be easily overcome, even if it is quite clear that the process’s quality of assuring non-financial information is going to increase. Maroun has suggested a fourth model through which companies could apply assurance.

4.3.4 Interpretive Assurance

The last model proposed by Maroun is the most recent. It has been published in an academic paper in 2018, so the author is trying to describe the needs required by the firms to be assured and the tasks that auditing firms could performed, taking into account the real legal and jurisdictional conditions.

To introduce the Interpretive Assurance model the author has pointed out that all the previous assurance models “are not source of “assurance” in the “true sense”, because an independent practitioner has not “tested the integrated report” according to a formal assurance framework\(^{241}\), destroying his own models developed so far. The new method of ensuring data is composed by three stages:

1. “Completeness of analysis”; the first step is based on running a complete analysis on how the organization is able to create value in the long term perspective. During this first step, all the “Content Elements” theorized by the IIRC have to be checked, so the “entity business state” has to be clearly understood because “a detailed understanding of the entity business states is “paramount” because without it, the auditor loses the ability to identify the scope and the nature of the business states that the management information intermediaries should be capturing and transforming\(^{242}\). So the first step consists of analyzing the whole firm: the industry in which it operates, the external economic conditions and competitors, the firm’s ultimate goals, the internal processes and activities performed, the people involved from an internal and from an external point of view, the stakeholders’ interests to protect. It is a long and time consuming analysis, but the author has stated that it would be necessary to “recognizes the fact that the organization operates in a complex system where different financial and non-financial variables are relevant for managing long-term returns”.

2. “Methodological thoroughness”; the second step’s aim consists of providing evidence on the first step, so testing the process of collecting data and the information obtained. The second stage is developed in two phases: on one hand, the preparers have to collect and process data which will be tested by both internal and external auditors later; on the other hand, the preparers can rely on “an informal pilot study technique”, meaning that they can submit the analysis already run to the Board of Directors and to the Ethics Committee in order to obtain their opinion about the content developed. In this context “the reliability of the final

\(^{241}\) Maroun W. (2018), “Modifying assurance practices to meet the needs of integrated reporting, the case for “interpretive assurance””, p.411, Accounting, Auditing & Accountability Journal

\(^{242}\) Maroun W. (2018), “Modifying assurance practices to meet the needs of integrated reporting, the case for “interpretive assurance” ”, p.413, Accounting, Auditing & Accountability Journal
"report content" depends both on auditors (internal and external) and on the pilot programme. The scope that organizations have to achieve consists of “corroborating the analysis provided on the company’s activities”. In general, it seems to be easy to submit the report’s contents to all the professional figures above stated, but in reality it is a complex process due to the different people’s skills and due to their different perspectives and interests; the methodological accuracy on the processes & data that the firms aims to reach, could be transformed in a sort of time consuming and chaotic process because of the large number of people involved, discouraging the companies rather than motivating them to provide a higher quality assurance.

3. “Consultation and discussion”; the last step is strictly related to the previous one, in fact, it consists of consultation and discussions among members of the Board and of the Committee about the report’s contents. The review from “those charged with governance” could be perceived as a motivational tool for the IR prepares, because BoD members would be accountable for their technical comment on the contents, meaning that they would encourage the prepares in achieving a very high level of completeness and accuracy for the report. Moreover, the BoD and the Ethics Committee members would both feel more involved in the assurance practices, increasing their requirements for IR data evidence.

All the three steps could be summarized in a table formulated by the author in his paper:

<table>
<thead>
<tr>
<th>completeness of the analysis of the value creation process</th>
</tr>
</thead>
<tbody>
<tr>
<td>The rigour of the methods used to compile qualitative/subjective/forward-looking analysis included in an IR</td>
</tr>
<tr>
<td>Reasonability of the review process carried out by those charged with the reporting entity’s governance</td>
</tr>
</tbody>
</table>

Table 9- Elements of the Interpretive Assurance Model

243 Maroun W. (2018), “Modifying assurance practices to meet the needs of integrated reporting, the case for “interpretive assurance””, p.413, Accounting, Auditing & Accountability Journal
The Interpretive Assurance model proposed by Maroun is much more complex than the previous ones, due to the participation of many professional figures and their relationships, due to the combined work of external and internal auditors and due to the involvement of both top executives and their subordinates.

The previous models could be perceived as prototypes, meaning that the non-financial assurance development would be a long process to face with; advantages and drawbacks would be compared continuously and both firms and auditors would have to work into close contact to improve the current level of assurance. All the characteristics related to the already mentioned models are summarized in the following table:

<table>
<thead>
<tr>
<th>Assurance on</th>
<th>Restricted Model</th>
<th>Integrated Model</th>
<th>Delphi-inspired Model</th>
<th>Interpretive Model</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial info</td>
<td>● ●</td>
<td>● ●</td>
<td>● ●</td>
<td>● ●</td>
</tr>
<tr>
<td>Non-financial info</td>
<td>○</td>
<td>● ●</td>
<td>● ●</td>
<td>● ●</td>
</tr>
<tr>
<td>Guarantee provided by</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Internal auditors</td>
<td>●</td>
<td>● ●</td>
<td>●</td>
<td>● ●</td>
</tr>
<tr>
<td>External auditors</td>
<td>● ●</td>
<td>●</td>
<td>●</td>
<td>● ●</td>
</tr>
<tr>
<td>High-skilled experts</td>
<td>○</td>
<td>○</td>
<td>● ●</td>
<td>○</td>
</tr>
<tr>
<td>Professionals involved</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Preparers</td>
<td>● ●</td>
<td>● ●</td>
<td>●</td>
<td>● ●</td>
</tr>
<tr>
<td>Top executive</td>
<td>○</td>
<td>● ●</td>
<td>○</td>
<td>● ●</td>
</tr>
</tbody>
</table>

Table 10- Models’ Characteristics

- ● ● High level
- ● Low level
- ○ Absent

4.4 Real Case: the ABN AMRO Group N.V.

In this section an example of external assurance provided to the Integrated Report is examined. It is the case of the “ABN AMRO Group N.V.”, which is “a leading full-service bank with a transparent and client-driven business model, a moderate risk profile, a clean and strong balance sheet with predominantly traditional banking
products, and a solid capital position and strong funding profile\textsuperscript{244}. The IR to which the analysis is referred to, is dated on 2017, and in its review, its auditing firm has provided the report with the non-financial information assurance.

Before looking at how the company has decided to compose the IR and how the external auditors have ensured it, it would be better to comprehend the reason behind the IR’s adoption from the bank point of view; in the following statement taken from the IIRC website, the Head of Business Advisory, Reporting & Stakeholder Management of the Group has explained his perspective about IR: “At ABN AMRO, we consider financial and non-financial value to be equally important. I have found that the process of creating an Annual Review works like a management tool: it raises questions, introduces discipline, and gives us insight into the non-financial value we have created in the previous year and what steps we need to take in order to keep creating sustainable value for all our stakeholders. Our integrated reporting helps make this value transparent”. It appears quite clear that the company aims at improving its quality of doing business, giving the same relevance to both financial and non-financial performances. It has decided to seize the Integrated Report preparation as a tool to implement both its own internal activities and the relationship with its external stakeholders.

The review of the IR contains the most relevant events and data related to the bank such as the strategy pursued in both medium and long term, the value creation process, the analysis of capitals utilized and the financial statements. What appears to be really useful is the list of the material matters indentified by the company, because once they have been established, it would be possible to evaluate whether the company is disclosing information related to these objects and whether it is enforcing and protecting them within its strategy. Once the materiality has been dealt with, the assurance is taken into account and the auditing firm chosen by the bank, EY, has provided its guarantee.

The auditing firm Ernst & Young has expressed the process\textsuperscript{245} adopted to evaluate the bank’s non-financial information:

1. “performing an external environmental analysis and obtaining insights into relevant social themes and issues in the sector, the characteristics of

\textsuperscript{244} IIRC website, “What ABN AMRO says about its journey towards <IR>”.
\textsuperscript{245} ABN-AMRO Integrated Annual Review, “Assurance report of the independent auditor”, pp.80-82
the organization and the themes that are most relevant to achieving the organization’s long and medium term strategy”

2. “obtaining an understanding of the value creation model”

3. “evaluating the appropriateness of the reporting criteria used, their consistent application and related disclosure in the Integrated Annual Review”

4. “obtaining an understanding of the reporting processes of the Integrated Annual Review”

5. “identifying areas of IAR where material misstatements, whether due to fraud or error, are likely to arise, and performing further procedures aiming at determining the plausibility of the IAR responsive to this risk analysis”

6. “evaluating the presentation, structure and content of the Integrated Annual Review as a whole”.

The process can be run only if the company, in this case the bank, has already identified its relevant areas, so all those material objects that are necessary to perform the strategy. In order to obtain an assurance, the company itself has to be aware of which are their activities, processes, used resources and future goals to achieve; subsequently, the auditing firm could evaluate the social and environmental indicators performance.

In the guarantee provided by EY on non-financial data, it is clearly specified that all the “actual future results are uncertain” and as a consequence it does “not provide any assurance on the assumption and achievability of prospective information”, so even if the material information is judged, all the future expectations cannot be ensured, as it was already pointed out in the external assurance section. As regards all the other contents of Integrated Annual Report, the auditing firm has guaranteed that they are prepared in accordance with the Framework published by the International Integrated Reporting Council.

The case of ABN-AMRO confirms the fact that providing external assurance to the Integrated Report is possible even if it requires several efforts both by the company and by the auditors. In the previous section all the drawbacks related to external assurance have been explained in details, however the positive effect of having the IR assured is shown and it could be perceived as inspirational for all the companies which want to provide an assurance service, reminding that the ultimate goal is to improve the
quality information disclosure to the market, in order to create a more sustainable economy at global level.

4.5 Internal Assurance

The external assurance has been analyzed in details in the previous section, however, it is not the only way through which the organizations could provide an assurance to their data. It is quite clear that, the external assurance is needed in order to ensure that the information reported is trustable and valuable and that it does not consist only in “good actions” performed by the companies; on the other hand, the internal assurance is necessary to guarantee that all processes are performed according to the internal policies, in order to protect the firm’s activities from an internal point of view. In the following part, the internal assurance and its main components are going to be described.

4.5.1 Reasons behind the Internal Assurance Adoption

Before explaining the role and the composition of the internal assurance, it would be better to introduce the reasons which lead the companies to implement the internal assurance as first tool to guarantee information.

First of all, it would better to remember that the assurance is necessary for the companies in order to maintain their reputation and so their customers’ attractiveness, their trustability and, as a consequence, their capacity of attracting both external investments and professional workforce. At this point, the reasons why the assurance is provided at internal level at first, could be examined.

The first reason consists in the “preference for voluntary, self-regulation rather than for a mandate approach”\(^{246}\), meaning that the organizations prefer to manage themselves also in the case of assurance, instead of leaving the external auditing firms to be involved in the process. This approach could be justified by the fact that nowadays the companies operate under very uncertain conditions, which force them to be flexible and adaptable to different scenarios and to develop products & services in a very innovative way; each company has to be able to survive in a different way, meaning that it would be really difficult to catalogue companies through a traditional system, grouping together the ones belonging to the same sector. This implies that, apart from the legal norms which have to be strictly observed, the companies would prefer not

having other forms of mandated rules to follow, in order to be able to react to market changes in a faster way. To better explain the concept, it is reported a comment provided by an internal auditor which has stated: “I think they (companies) should put in assurance process which are appropriate to the needs of their business and to the needs of their audience”\textsuperscript{247}, he has highlighted the need for assurance, but limited to those areas which each company considers “appropriate” to be ensured, also taking into account the requirements of its “audience”, so, the internal assurance would be more convenient according to this perspective.

In contrast, it would be better to defined that “having an effective audit process will help, but it is not a panacea”\textsuperscript{248}, implying that the internal assurance could be useful to run the business, however, if the processes are not performed in the proper way, having the assurance or not does not matter.

The second reason behind the adoption of internal assurance rather than external one, would be the cost-benefit analysis. It is obvious that hiring an external audit firm to ensure non-financial data would be much more expensive than adopting only the internal processes to guarantee the same data. The high costs, defined in the same article “horrendous costs involved” for external assurance, are mainly due to the uncertainty in the procedures to follow for the practitioners. As a consequence, the organizations, which do not have the economic opportunity to ensure their pre-financial data, would restrict the assurance to the financial part only. These two reasons do not seem to be enough robust to avoid the external assurance provision, however, in both cases, the companies prefer to invest in internal assurance in order to be completely aware of how the activities are run, from the bottom to the top of the organization.

4.5.2 Internal Assurance’s Composition

In the previous chapter it has been already introduced the corporate governance’s role and composition; in this section, other parts of corporate governance are going to be analyzed: the controllers and the internal auditors. Merchant and Van der Stede in their book “Management Control System”\textsuperscript{249} have outlined the characteristics of these two roles at the basis of the internal assurance process. Before


the analysis, it would be better to emphasize the two relevant functions at the basis of these professions: the “management service” duty and the “oversight” one. In the first case, both the controllers and the auditors are perceived as figures who can help the managers with “their decision-making and control functions”; while, on the other hand, the “oversight” function aims at monitoring whether all the activities, included the managers’ activities, are performed properly and whether they are “legal, ethical, and in the best interest of the organization and its owners”. These two functions are completely different one from the other, implying that, when these are performed by controllers and auditors, there could be some conflicts of interests which have to be managed.

The first role described would be the controller one, and how it could support the internal assurance activities. The tasks carried out by the controllers are mainly three: the “external financial reporting”, the “management control system” and the “internal control” one; for the purpose of this work, the focus would be on the last activity: how the controllers perform the “internal control”, which is defined as “ensure both the reliability of information and the protection of company’s assets”. It is quite clear from the definition, that the “internal control” role implies the controllers to follow the “oversight” duty with respect to the organization. In order to guarantee that the information is reliable and trustable, the controllers are required to have a fundamental characteristic: independence; the controllers have to check and monitor the others’ tasks, so they can establish any particular kind of relationship neither with other employees nor with their supervisors, in order to maintain their unbiased view on the organizations’ activities. They have to maintain their integrity and to do so, the majority of companies has determined the “solid-line” reporting, meaning that the controllers at unit level have to report their judgements directly to the corporate controller, who fulfils the most powerful position among all the controllers of the organization and who, in turn, would report the results to the Chief Financial Officer.

Performing their “oversight responsibility” makes the controllers the first component of the internal assurance, while the second one is composed by the internal auditors. The role of the external auditors has been already specified in the previous part, however, in this section, some internal auditors’ characteristics and the processes performed by them are highlighted.
First of all, it would be better to remember the main procedure which the auditors have to follow, the “systematic process”, which is mainly composed by three steps: “objectively obtaining and evaluating evidence regarding objects of importance”, “judging the degree of correspondence between those objects and certain criteria” and “communicating the results to relevant users”. This process is necessary to ensure the validity of both activities and information.

Within the organization there exist several types of audit, which monitor different areas one from another:

1. “Financial audit”; the financial auditors are responsible for all the financial statements generated by the organization; they perform the same tasks and monitoring processes which would be later run by the external auditors.
2. “Compliance audit”; these internal auditors are accountable for “expressing an opinion as to whether actual activities or results are in compliance with the established standards, rules and regulations”.
3. “Performance audit”; the internal practitioners are held accountable for the results obtained, which are then compared with specific criteria previously defined. The current performances should be at least near to the targeted ones, in order to be sure that all the expectations provided to the investors are reliable.

In general, the internal auditors favour two main advantages to every organization: on one hand, “the audit report adds credibility to the information provided”, so the auditors are generating value for the company as a whole, and “as by product” they are able to identify those areas which need improvement in terms of information disclosure; on the other hand, they are able to generate the “anticipation” effect, which means that, knowing the internal auditors would control the activities, results and data provided at the end of each process, the employees are more encouraged to perform according to the internal policies and to report verifiable and trustable data; they perform a sort of “motivational tool” for all the workers involved.

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Both controllers and auditors are people who embody the internal assurance, furthermore, there are some related features which could affect their influence on the assurance process both negatively and positively.

4.6 Determinants of Internal Assurance

At this point, it would be interesting understanding which features, or determinants, influence each mechanism of internal assurance. In the following section, several studies related to the above mentioned determinants are going to be adopted.

The first determinants’ analysis is related to the Audit Committee, which is describe as “a significant corporate governance mechanism to control agency problem and improve disclosure\textsuperscript{251}”, with the aim of “overseeing integrated report...the audit committee should have regard to all factors and risks that may impact on the integrity of the integrated report\textsuperscript{252}”. There have been identified several determinants related to the Audit Committee; the first one which would be analyzed is the “size” of the Committee.

The “Size” determinant could influence positively the Committee due to the fact that having a larger group of people in the Committee could lead to several points of view, collecting different ideas of how to monitor activities. On the other hand, it could also affect negatively the capacity of the Committee because a larger number of people could slow down the decision-making process, creating a lack of efficiency\textsuperscript{253}. As a consequence, the “Size” could have a double effect.

The second determinant introduced by the same authors, Ahmed Haji and Anifowose, consists of the “Independence” of the Committee. The relevance of independence has been already emphasized in the case of external and internal auditors, as a consequence, the “Independence” determinant becomes essential also for the Audit Committee. The authors have mentioned two main theories according to which the “Independence” is needed and so, could support the assurance process: on one hand, it has been expressed, once again, the “agency theory” with the main aim of “detecting and reducing the fraudulent reporting practices”, enhancing the reliability of data provided; on the other hand, the “socio-political theories” have been introduced, stating


that the independence of auditors could be perceived as “symbolic”, with the ultimate goal of gaining “organizational legitimacy”, so without taking into account the real necessity of ensuring information, but focusing the attention on the firm’s appearance. In a similar way, Akhtaruddin and Haron have stated that the “Independence” determinant could improve the assurance process due to the fact that the “formation of AC with more outside directors indicates less interference from management to exercise their independence, and better quality of reporting”. It seems to be quite clear that the “independence” feature could affect the Audit Committee, and so the internal assurance, in one way only: a positive one.

Another determinant related to the Audit Committee is the “number of meetings” arranged. Usually this feature is perceived as a positive determinant because if the Committee decides to meet several times in a year, it implies that it is interested in the organization’s situation. As a matter of fact, “the frequency of audit committee meetings is an indication of committee activeness and by extension effectiveness”. However, it seems to be a little bit tough to demonstrate a real correlation between the “number of meetings” and the improvement of internal assurance, so, for this reason, there could be the possibility of considering this determinant also as non-influencing factor.

One of the most important determinant related to the Audit Committee is its “Expertise”. It is quite obvious that having an internal Audit Committee which is mainly composed by people with financial knowledge would increase the credibility of the report provided. As a matter of fact, “academic research shows that presence of financial experts mitigates conflicts between management and external auditors; curbs well internal control weaknesses; results in positive capital market reactions; and enhances financial and non-financial disclosure”, so the “Expertise” determinant seems to have a positive impact on the internal assurance process. In a more concise way, Akhtaruddin and Haron have stated “expertise of AC members is expected to contribute to AC effectiveness”. So, from the above mentioned statements, it appears clear that the Audit Committee’s “expertise” could influence positively the assurance process.

The last determinant analyzed is the “Authority” given to the Audit Committee. In the first part of the section regarding the internal assurance, it has been described the role of internal auditors, underlying the fact that one of the main tasks performed consists of the “oversight responsibility”, which has been explained as the auditors’ duty to control and monitor all the activities and their relative data. If the auditors have the power to check whether the processes were performed, this implies that they own the “authority” to do so, and they would be held accountable for the review by both the internal management and external stakeholders. Having more “authority” means that auditors would have the responsibility of completely ensuring the report, so, as a consequence, it would be possible to state that the “Authority” feature could positively affect the Audit Committee efficiency.

All the determinants related to the first “mechanism” of the corporate governance, the Audit Committee, have been explained in details, however, several authors have had the opportunity to prove just some of them, emphasizing the real correlation between each determinant and the Audit Committee’s effectiveness, which in turn results in the internal assurance efficiency. To simplify the findings’ understanding, they are collected in the following table:

<table>
<thead>
<tr>
<th>Determinants of Audit Committee</th>
<th>Influence on Audit Committee Efficiency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Size</td>
<td>No</td>
</tr>
<tr>
<td>Independence</td>
<td>Yes</td>
</tr>
<tr>
<td>Number of meetings</td>
<td>No</td>
</tr>
<tr>
<td>Expertise</td>
<td>Yes</td>
</tr>
<tr>
<td>Authority</td>
<td>No</td>
</tr>
</tbody>
</table>

Table 11- Determinants’ Influence on AC’s Effectiveness

The determinants of another corporate governance mechanism are going to be analyzed; this mechanism is the “Environmental Committee”, which is presented as “an important component of the corporate governance practices to address sustainability

---

risks and opportunities\textsuperscript{257}. The Environmental Committee supports the activities of the Audit Committee with a major focus on the sustainable development of the firm’s strategy. The determinants related to the Environmental Committee are reported by the authors Peters and Romi in their academic paper.

As in the case of Audit Committee, the first Environmental Committee’s determinant is the “Size”; the authors have supported the hypothesis that “greater is the number of individuals assigned to” the Committee and better would be the impact on the assurance efficiency. The reason seems to be quite simple to comprehend, a higher number of people involved in the committee implies a higher level of internal control over data, and as a consequence a better internal assurance. However, the drawbacks is always existing, in fact, a greater number of individuals makes the decision making process more complex and long to manage.

The second committee’s determinant is the “Expertise”, which in this case “promote greater sensitivity to reporting risks and deficiencies, leading to a greater...engagement with assurance providers”. So, as in the case of Audit Committee expertise, the Environmental Committee would benefit from an increasing level of knowledge of its members, however, it would result a difficult process maintaining such a high level of skills and capabilities in that committee. The authors support the positive correlation between the Committee’s “expertise” and its willingness of providing the internal assurance.

The other feature related to the Environmental Committee consists of the “Independence”. As already explained in the previous parts, generally the independence of committees could affect positively the process of information disclosure and, as a consequence, the subsequent assurance process. This occurs also in the case of Environmental Committee, where the independence of members could ensure to external stakeholders a better information disclosure process and a more efficient assurance one. For this reason, Peters and Romi have stated that there exist a positive correlation between Environmental Committee’s “Independence” and its assurance provision.

The last determinant associated to this Committee is the possibility that some individuals would be overlapped between different committees. According to the academics “firms with greater overlap between the environmental committee and the

audit committee will increasingly seek assurance\textsuperscript{258}, due to the Audit Committee’s need of ensuring financial data. So, taking into account all the determinants related to the Environmental Committee, the authors have assumed that all of them would positively affect the demand for internal assurance, however, at the end of their paper, the previous hypotheses have been changed, and it has been proved that only the “expertise” of Environmental Committee could really influence the assurance process\textsuperscript{259}.

The last determinants’ analysis is related to a new professional figure, the Chief Sustainability Officer. “The CSO represents a relatively new position within the firms’ management team”, as a consequence, the tasks performed by this internal professional are not already so clear, however they consists of:

1. Supporting the sustainability activities from a strategic point of view, highlighting which could be the possible sustainable improvements to pursue. The CSO has the duty of helping the “CEO and the executive team...in aligning environmental and social visions with business strategy”, so the figure seems to have a powerful position during the decision making process.

2. Ensuring the reliability of sustainable data published in the firms’ reports, which means that “the assurance practitioners attempt to influence (CSO) when developing and legitimating a new assurance service”, due to its role of information assurer.

For these reasons, the CSO is responsible for the sustainable information disclosed and as a consequence, it can be perceived as a figure which enhances assurance, improving it. However, the CSO should possess several skills to perform his/her tasks, implying that the company should invest a lot in this professional figure which perhaps is not extremely necessary. Moreover, the management team is already interested in providing truthful information to “signal its greater ability” both to internal and to external stakeholders. So, the hypothesis supported by the academics shows that the “presence of a CSO is not associated with” a better level of assurance, meaning that, even if the professional could bring benefits to the organization, the drawbacks overcome the advantages and the internal assurance process is not improved. However, the results


obtained by the regression analysis run by the authors, confirm the opposite, so the Chief Sustainability Officer seemed to be really useful in enhancing the assurance system.

All three major figures related to the internal assurance have been analyzed, and for all of them (Audit Committee, Environmental Committee and CSO) the influencing determinants have been identified. In the following table only the features which positively affect the mechanisms and as a consequence, the internal assurance, are reported:

<table>
<thead>
<tr>
<th>Audit Committee</th>
<th>Environmental Committee</th>
<th>Chief Sustainability Officer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expertise</td>
<td>Expertise</td>
<td>Presence of CSO</td>
</tr>
<tr>
<td>Independence</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 12- Determinants Influencing AC, EC & CSO’s effectiveness

4.7 IR’s Assurance Future

To summarize the content of this chapter, it would be better to focus on the benefits that the assurance process could bring to the organizations and compare them with the drawbacks that the companies have to face. For the purpose of this work, it would be interesting to take into account both the point of view of internal assurers and of external ones, in order to really comprehend which could be the future of the IR’s assurance. Moreover, it would be better to remember the reader that the Integrated report is at its early stage, so it is its assurance service and both companies and assurance providers are currently understanding in which directions it would be better to proceed.

Starting from an internal perspective, it would be necessary to comprehend whether the internal practitioners support the IR’s internal assurance development or not. As it has been already explained in the part of internal assurance, the internal auditors are those people who are firstly held accountable for the information provided to the stakeholders. Due to this responsibility, the internal auditors would require specific guidelines according to which provide the most complete data, however, both the environmental and the societal performance indicators are not so well developed and as a consequence, the internal auditors are not so willing to be hold as responsible for information disclosed. A similar concept has been stated during an interview, already mentioned in the previous part; a practitioner said: “effective social and environmental
assurance practice was dependent on the underlying environmental and social management processes. Given that these were currently inadequately developed, the assurance itself was likely to prove largely ineffective\textsuperscript{260}, meaning that the assurance has to be provided but the performances related to environmental and social goals are not already clearly identified, and so it is not possible for internal controllers to ensure all data completely.

Moreover, from an internal point of view, there exists another issue that needs to be solved and which is strictly related to the real auditors’ perception about the IR’s assurance process. In the Jones and Solomon’s paper, several interviewees, mainly composed by auditors and preparers, have expressed the idea that the sustainable performances are not so relevant to be ensured: “there was the feeling, shared by several interviewees, that social and environmental reporting was not as important as financial accounting and reporting” and other meaningful words expressed by an interviewee were: “I think there is too much auditing being proposed at the moment. The auditors should be auditing what is truly important to the company which is their financial results and financial state of stability”\textsuperscript{261}. From the previous statements, it is clear that the auditors’ perception about guaranteeing non-financial information is not so positive; even if they are the first people involved in the process, it seems that they do not believe in it and this fact would be harmful for any future development.

From the point of view of external auditors, the feeling is similar to that of internal ones. In the paper of Atkins and Maroun it has been mentioned by a Big Four audit partner: “you can very much create a perception or image of an organization with what you say in the integrated reports...I am not suggesting that people blatantly lie in their reports but I think that playing with words becomes an issue and there might be a bit of carte blanche with freedom of speech\textsuperscript{262}”. It is obvious that the external auditors would be held accountable for the content of IR, and knowing that the large part of the IR’s contents is expressed in a narrative form, there exists the risk of misleading the reader, publishing ambiguous information. However, it would be better to remind that, the IR’s assurance practices are currently developing and that, any type of future improvement could be considered as a potential profit for the auditing firms which are


interested in providing this service. So, even if on one hand the external practitioners seem to be unwilling to provide assurance, on the other hand, they would do it because of the enormous profit margin that it could generate in the future.

To conclude, there exist several challenges that the IR’s assurance process shows and that have been already explained in this chapter, such as “whether traditional assurance models will be an appropriate fit for <IR>” or the fact that “the broader subject matter means an increased complexity in the assurance skill set required, potentially requiring multidisciplinary teams” and as a consequence “whether the cost of assurance on an integrated report will be disproportionate to the perceived benefits”\(^{263}\). Not to mention the lack of clear guidelines to judge all the non-financial contents on one hand, and the lack of unique professional figures which have enough skills and capabilities to evaluate all the material matters of the report on the other hand. To consider the <IR> as a mandatory report it would be necessary the assurance, so until the issue of assurance would not be solved, the adoption of Integrated Report would remain at firms’ discretion.

5 Conclusions

In the last decade, due to an increasing need shown by society, which has required the organizations to be more accountable for their performances both at financial and non financial level, some international bodies have introduced a new form of corporate reporting: the integrated reporting process. The aim of this work consisted in developing a deep analysis of the main features of the IR, taking into account both the positive aspects generated by its adoption and the main critiques that have been posed by some early adopters and several academics. As a matter of fact, the scope of the entire work is not only to support the IR as a new form of reporting process, but also to provide some interesting insights of which are the main issues and which directions could be followed for their solutions. The raison d’etre of the IR appears to be self-explained since the new global conditions and the high level of connections among all the economies justify the societal need to ask for higher levels of transparency, trust-ability and responsibility to those entities operating in the market.

For this reason, from a content point of view, the main concept at the basis of the Integrated Report is the “integrated thinking”, which consists of providing an “holistic picture” of the company, where the societal and environmental performances assume the same relevance as the financial results do. From a traditional point of view, the pre-financial performances could not be represented at the same level of the financial ones because of their narrative form and the extreme difficult process of quantification of these performances. However, the IR offers a new perspective of reporting information, which could be disclosed both in quantitative and in qualitative terms. As example, some newest element required by the IR consist in the business model and future outlook descriptions, which cannot be drawn up only in quantitative terms but which require narrative articles to be expressed in the best way.

So, as the contents are more integrated among each other, also the form of the report should appear to be more descriptive as well as more concise. In this context the conciseness seems to be the first real issue which the organizations have to face with, since being accountable for more data means disclosing a larger amount of information, which turns out to generate longer and tedious reports, which would not be the ultimate goal of the regulatory bodies. To remain royal to the major aim of the IR, the IIRC (International Integrated Reporting Council) has introduced one of the most important features to use during the drafting process of the integrated report: the materiality.
analysis. It consists of identifying those matters which are at the basis of the organizations activities and as a consequence, they need to be disclosed to the market. Even if at first sight, the materiality analysis could be perceived as an easy task to perform, it is not since few tools have been developed to tackle this issue. Several international bodies have provided specific methods to identify material objects, and probably one of the most effective is the materiality matrix developed by the American SASB. This tool is industry-specific, which means that the most relevant characteristics related to each sector have been already catalogued by the SASB, and the companies are only required to fulfil the matrix with their own data, which in economic terms means a huge reduction of the expenses since the organizations do not need to invest in the employees’ training and education as regards materiality nor to invest in developing their own matrix studying their industry features.

The positive aspects related to the materiality analysis are several and, in some ways, they enforce the already existing advantages led by the voluntary information disclosure. As a consequence, the organizations need to run the materiality analysis to provide the investors with only relevant information, allowing them to make more informed decisions. At the same time, disclosing material matters could be considered as a strong signal to the market, communicating transparency and a high level of awareness of their own activities, increasing their reputation and a positive perception from the investors’ point of view. Moreover, if the potential investors possess more information about the companies’ performances, the information asymmetry would be reduced, with a positive reduction in the cost of capital.

However, respecting the original intent of providing both the positive and the negative aspects related to this new form of reporting, it would be better to state also the drawbacks which the organizations have to deal with when they perform the materiality analysis. First of all, the relevant findings that the organizations could have identified should be both positive and negative features, and since they have to respect the IR’s principle of providing a fair picture of their situation, they are forced to disclose also their negative results, damaging their reputation. Furthermore, a direct consequence would consist in explaining the stakeholders the reasons behind the negative results, reasons which sometimes are not even clear to the company itself and posing the company out of control for its own disclosure. So the direct consequence is being in an uncomfortable situation, which could discourage the companies from adopting this new form of reporting.
On the opposite side, assuming that the companies are completely aware of their actions and consequences, disclosing relevant data could cause them to lose competitive advantage which ultimately is the worst scenario for a company. So the materiality analysis and the relative disclosure of data would be extremely important to respect the IR’s principle, however, the organizations should be aware that severe drawbacks could impact their business.

Another issue presented in this work is strictly related to the accomplishment of the IR preparation: the connectivity of information.

As it has been reported in the third chapter, the connectivity of information is extremely important to create a real Integrated Report, since it is due to the connections of data that the external reader of the report could perceive the complete and holistic picture of the firm. From a theoretical perspective, as already expressed in details in this work, the organizations should be able to establish interdependencies among data in several ways such as some connections among the Content Elements, which is probably the most relevant type of connectivity since the used resources would be related to the activities and to the final organizational outputs and outcomes; strictly related to this type of connectivity, since in some ways it is impossible to identify the former one without the second one, there exists the relation among the six capitals adopted by the organizations, so the recognition of inputs, outputs and outcomes. Then, extremely important it is also to look at the relation among past, present and future perspectives, in order to be fully aware of the existing competitive market and to plan the future strategy, as well as to be able to recall the past performances in order to structure a continuous process of development and innovation, avoiding the risk to fall in the “learning trap”. The last type of connectivity expresses the capacity of the organizations to align the internal communication with the external information disclosure, which is meaningful especially when the data disclosure should be an effective process and the firms are accountable for their activities.

If the connectivity identification process appears to be quite easy to manage from a theoretical point of view, it is not, since the companies have to face several issues: first of all, the pre-condition to run a connectivity analysis implies that the company has coped with the materiality issue, otherwise the risk of being overwhelmed by the huge amount of data and connections would become real; so, once the material data are possessed by the firm, it should be able to catalogue them in the six capitals and subsequently to develop the Content Elements, which in turns requires the ability to
figure out both the ongoing activities and performances and the potential future opportunities to seize, highlighting the time-horizon and maintaining the attention on the market uncertainties and risks to deal with. The main drawback associated to the connectivity analysis is that nowadays no efficient tools have been developed to assess the level of connectivity reached by a firm; so, two main negative consequence are generated: on one hand, the companies which have started the integration process a decade ago do not have clear connectivity thresholds, implying that they could identify continuous connections, creating a never-ending process; on the other hand, those organizations which have not yet started to apply the new form of reporting are not motivated to, since the process is not well defined and there is a high possibility of wasting time and economic resources in attempting to run such an analysis. As described in the chapter, the connectivity of information process requires further development both from an academic point of view, trying to explain in what does it consist, and from a practical one, creating tools easy-to-use, which do not require huge investments for the companies.

The last issue presented in this work has concerned the assurance of non-financial information, a challenge which is extremely relevant both for the organizations and for the auditing firms. It is worth to state that the assurance of social and environmental information would provide the organizations with a lot of benefits, since it would increase the level of credibility and reliability of data, enforcing the firms’ disclosure process, raising the companies’ reputation, protecting both the stakeholders and the market from worthless information and signalling which organizations have really put efforts in their activities and which of them have been simple story-tellers. At the same time, the auditing firms could reach a higher level of skills and capabilities in ensuring pre-financial data, as well as increasing their market opportunities. However, the assurance issue seems to be far from the resolution.

During the last decade, several models to evaluate the non-financial data have been developed, mainly by some academics. Maroun has developed the Restricted model, not so different from the traditional way of evaluating only financial data and for this reason it has been immediately abandoned; then the same author has proposed the Integrated model and the Delphi-inspired one, but both of them were not a success due to the huge investments required to the companies in hiring both internal high-skilled auditors and external professionals. The latest one has been developed during the first part of this fiscal year and it has been named Interpretive model. It implies the supervision of the
entire integration reporting process from top to bottom of the organization and from both internal auditors and external ones, which implies that the non-financial information has to be continuously monitored by the direct prepares of the report and then approved by the top executives, which would be responsible for it as well as the internal auditors would be held accountable. Once the report will be drawn up, the external auditors would assure it. The process is quite similar to the one developed for the financial information but it would be better to remind the reader that ensuring non-financial data implies the guarantee also of forward-looking information, which basically is the major concern both for organizations and for external auditors. Assuring a complete Integrated Report requires skills and capabilities which actually the auditing firms and the internal professional do not possess, mainly due to the fact that both the social and the environmental data are difficult to quantify in monetary terms and that the inclusion of expectations makes the assurance process extremely tough, and almost impossible. So far, the auditing firms have provided a so called limited assurance to organizations, meaning that they can offer an opinion about the social and environmental data but they do not ensure them, in order to not be liable from a legal point of view for data which cannot be evaluated from a subjective perspective. The immediate consideration is that the pre-financial data would never be ensured from a traditional point of view, however, the journey of the Integrated Report is at its early stage and so it is the assurance one, which implies that further developments would take place in the next years.

To conclude, the purpose of this work was to have a deep insight into a new form of corporate reporting which is becoming more and more common especially among huge international companies. Apart from the idealistic ultimate goal of evaluating the social and environmental data at the same level of the financial ones, the real interesting perspective has been on how the international bodies, the companies and the auditing firms are trying to face with existing issues and challenges. A comprehensive comment is that the IR structure has been developed on the basis of existing lack of companies’ disclosure and taking into account the society’s need to consider someone liable for market troubles and severe economic consequences; however, these reasons seem to be not enough to develop a real efficient new form of corporate reporting, since the materiality analysis as well as the connectivity one are extremely relevant to establish which data should be disclosed, otherwise there would be an opposite effect: overloading the external market with worthless data. Moreover, no attention has been
paid by the international bodies on the assurance process, and the consequence is that both the organizations involved in the process and the auditing firms are trying to manage this issue with a lot of troubles.

The clear consideration is that the Integrated Reporting process needs to be further developed, solving some practical challenges which could threat the utility of this new form of reporting. According to my personal opinion, this new form of corporate reporting could really offer new opportunities to raise both the transparency in the information disclosure process and the reliability of data, however some guidelines and tools that could be useful for drawing up the report, need to be implemented, as well as the idea of being accountable only for financial information without taking into account the social and environmental impacts should be overcome, both by existing stakeholders operating in the current market, and by the future ones, which in turns reflects the necessity for the universities to focus more on specific future corporate trends.
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