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Factors affecting preparers' and auditors' judgements about materiality and conciseness in Integrated Reporting

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This report provides timely evidence about emerging practice among corporate report preparers around the world in determining materiality and achieving conciseness. It investigates how corporate report preparers make decisions about what to report with reference to the International <IR> Framework, and examines to what extent this decision-making process is disclosed in corporate reports. It explores how the magnitude, likelihood and nature of items affect judgements about materiality.

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Factors affecting preparers' and auditors' judgements about materiality and conciseness in Integrated Reporting

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Foreword

As integrated reporting develops and becomes more widely adopted, organisations are learning much more about what informs the fundamental <IR> concepts of materiality and conciseness in practice and application.

This extensive and innovative report sheds light on how report preparers decide what to include in an integrated report and to what extent they are transparent about that decision-making process. The research also reveals that – while rarely specifically disclosed in the integrated report – reporters' views of the magnitude and likelihood of material issues play a key role in determining what to report.

From these research findings, it is clear that, as reporting becomes more multi-faceted and complex, the judgement and intelligence that professional accountants bring to bear on their reporting decisions will be ever more critical.

For our part, ACCA is ensuring that we continue to equip our members and future members with the skills and capabilities needed to drive transparent and joined-up reporting that goes to the heart of organisations' value creation. Through this report, the researchers shine the spotlight on the progress already made and the journey that lies ahead.

Helen Brand OBE
Chief executive
ACCA


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Executive summary

This study explores the issues of materiality and conciseness in Integrated Reporting (<IR>) from the perspectives of corporate report preparers, company auditors and users of reports.

This study explores the issues of materiality and conciseness in Integrated Reporting (<IR>) from the perspectives of corporate report preparers, company auditors and users of reports. Evidence was gathered about current <IR> practices and issues faced by practitioners in determining materiality and conciseness in <IR>. The aim of this report is to provide timely evidence about emerging practices that will be helpful for the further development of <IR>.

The research project, conducted over 12 months during 2014 and 2015, was based on three complementary activities. First, interviews were held with preparers of corporate reports to learn about their experience of <IR>, including making decisions about what information to include and how to achieve conciseness in their disclosures. Second, information was collected about the materiality determination process from disclosures in 195 corporate reports issued in 2012/13. The companies issuing the reports called them integrated reports or stated that they followed principles of intergrated reporting.

Third, a behavioural experiment with corporate report preparers and auditors investigated how the concepts of magnitude and likelihood affect their judgements about the materiality of items to be disclosed by companies in narrative reports.

The International Integrated Reporting Council (IIRC) was launched in August 2010, and the International <IR> Framework was published in December 2013, following the release of a consultation draft in April 2013. At the time of the research, the international <IR> initiative was therefore relatively new, and the identity of <IR> as distinct from other forms of reporting was still emerging. The reports reviewed as part of this research were published in 2012-2013 and include integrated reports and other reports (such as sustainability reports) by organisations at an early point in the integrated reporting journey. Some of the integrated reports were prepared following interim IIRC guidance and some were prepared following South African guidance included in King III (Institute of Directors in Southern Africa 2009).

The International <IR> Framework recommends that companies consider the magnitude and likelihood of occurrence when evaluating whether matters are material.

The purpose of an integrated report as per the IIRC is to meet the information needs of providers of financial capital. As part of achieving this purpose, an integrated report should 'provide insight into the nature and quality of the organisation's relationships with its key stakeholders, including how and to what extent the organisation understands, takes into account and responds to their legitimate needs and interests' (IIRC 2013b para 3.10). This differs significantly from the relevance of stakeholders in both:

(a) the guidance that existed in South Africa for integrated reporting prior to the South African IRC's adoption of the International <IR> Framework in 2014, and

(b) the guidance for sustainability reporting, where the purpose of the report itself is to meet the information needs of a broad range of stakeholders.

The reports reviewed as part of this research are collectively referred to throughout this paper as 'corporate reports.' They include integrated reports and other reports sourced from the <IR> Business Network, the <IR> Examples Database and companies listed on the Johannesburg Stock Exchange. Similarly, the interviews and behavioural experiments, which were conducted in 2014-2015, also reflect to some extent an early point in the integrated reporting journey, and a mix of views about the relevance of stakeholders other than providers of financial capital.

The results of the study are as follows. Interviews with preparers of both integrated reports and other reports revealed that many companies had a specific process for determining materiality that involved both internal and external stakeholders and a series of activities to identify, evaluate and prioritise material matters as recommended by the International <IR> Framework. The disclosure of the materiality determination process in companies' public reports generally focused on explaining the process they undertook to determine material items and providing a list of material matters. The processes of evaluating and prioritising items were often not described, which arguably is consistent with the strategic and commercially sensitive nature of the processes for the disclosing companies.

The International <IR> Framework recommends that companies consider the magnitude and likelihood of occurrence when evaluating whether matters are material. The interviews and review of corporate reports identified few explicit mentions of these concepts in relation to materiality. Nevertheless, despite the reports' silence on these concepts, other evidence suggests that they play a fundamental role in informing report content. A behavioural experiment conducted with professional accountants (auditors and business managers) showed that materiality judgements were associated with the magnitude and likelihood of items that could potentially be disclosed. Additional information linked to financial capital was more likely to be considered material than information linked to the social and relationship and natural capitals. (For the sake of conciseness, information linked to the social and relationship and natural capitals are referred to throughout this report as social and environmental information.) When comparing the effects of magnitude and likelihood levels on accountants' materiality judgements, magnitude dominated likelihood.

This study adds to prior literature by reporting the views of people who are leading practice in <IR> and comparing and contrasting what they said in interviews with a review of the content of disclosure about materiality in public reports. Evidence about professional accountants' views came from a behavioural experiment that explored magnitude and likelihood in materiality determination. In all these areas, the evidence extends current knowledge on the topic and therefore should be of interest to companies engaged or planning to engage in <IR> and other involved parties such as investors and other stakeholders, auditors, standard setters, regulators and government agencies.

1. Overview of the study

This study aimed to gather evidence about how companies determine material matters and achieve conciseness in integrated reporting (<IR>).

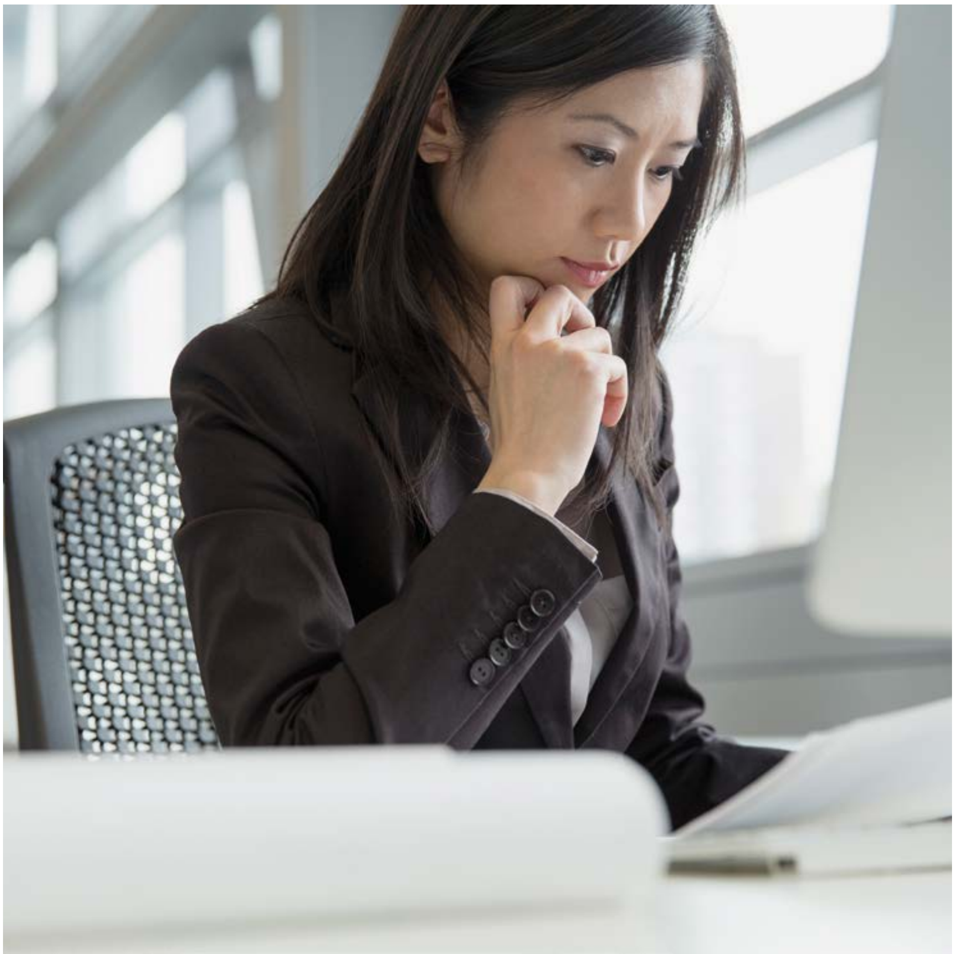
1.1 BACKGROUND AND MOTIVATION

This study aimed to gather evidence about how companies determine material matters and achieve conciseness in integrated reporting (<IR>). Materiality for financial reporting purposes is well-understood. Practitioners interpret the concept with guidance from law, standards and practice (IIRC and AICPA 2013). In contrast, materiality in <IR> is not so clearly articulated and understood. In addition, there are concerns that corporate reporting is too lengthy and complex and key messages are not being communicated effectively. Some people have called for more conciseness in reporting (FRC 2011; IASB 2014).

This study explores the issues of materiality and conciseness of disclosure in <IR> in three ways. First, interviews were conducted with preparers of corporate reports to learn about their experience of <IR>, including how they decide what information to include in reports and how they try to achieve conciseness in their disclosures. Second, information was collected about the materiality determination process from disclosures in 2012/13 integrated reports and other reports that were based on principles of integrated reporting. These reports were issued by 252 companies located in 28 countries. Third, a behavioural experiment with corporate report preparers and auditors investigated how the concepts of magnitude and likelihood affect their judgements about the materiality of items to be disclosed by companies in narrative reports.

The starting point was the guidance provided by the International Integrated Reporting Council (IIRC) in the International <IR> Framework. The Framework defines the integrated report as a 'concise communication about how an organization's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value over the short, medium and long term' (IIRC 2013b: 33). Further, the Framework states that materiality and conciseness are Guiding Principles for <IR>.

Materiality is defined as follows: 'a matter is material if it could substantively affect the organization's ability to create value over the short, medium or long term' (IIRC



One aspect which distinguishes the International <IR> Framework's approach to materiality from that of other financial reporting and sustainability reporting standards is that it moves away from a historical focus, adopting a more future-orientated stance.

2013b: 3.17). The Framework also states that an integrated report should be concise, that is, 'include sufficient context to understand the organization's strategy, governance, performance and prospects without being burdened with less relevant information' (IIRC 2013b: 3.37).

Thus, the Framework provides guidance on materiality and conciseness for preparers, auditors and users of integrated reports, while building on prior work in the area, for example by accountancy firms and other organisations (AccountAbility 2006; Deloitte 2012). A range of factors would be expected to affect the judgements of report preparers and auditors about whether possible items are material for disclosure purposes, in the context of the financial statements. Academic studies report that for auditors, materiality is commonly linked to measures of income (Messier et al. 2005). Other studies have explored how a range of factors beyond financial ones affect auditors' judgements about whether items are material. In the context of the financial statements, non-financial and qualitative information is used when assessing materiality, although it may be given less prominence (Carpenter and Dirsmith 1992; Krogstad et al. 1984). The International <IR> Framework suggests that an organisation's materiality determination process should consider the relevance of internal and external factors, as well as matters identified by stakeholders, in order to articulate how the factors affect the organisation's ability to create value over the short, medium or long term (IIRC and AICPA 2013). One aspect which distinguishes the International <IR> Framework's approach to materiality from that of other financial reporting and sustainability reporting standards is that it moves away from a historical focus, adopting a more future-orientated stance.

1.2 RESEARCH ACTIVITIES

One research activity consisted of a series of telephone interviews with companies involved in <IR>. One aim of the interviews was to gain further understanding of the materiality determination process (ie how those companies determine whether an item is material for disclosure purposes). Another aim was to discover more about how companies endeavour to achieve conciseness in reporting, which cannot be determined solely by reading the report disclosures. The interviews were conducted during December 2014–February 2015 with representatives of companies in the IIRC's <IR> Examples Database and <IR> Business Network Pilot Programme.[1] Managers from the corporate finance, corporate reporting, investor relations or sustainability reporting sections of 15 companies were interviewed. They represented six industry sectors (financial services, technology, industrials, basic materials, utilities and healthcare) and 10 countries (from Africa, North America, Europe, the Middle East, and the Asia-Pacific region).

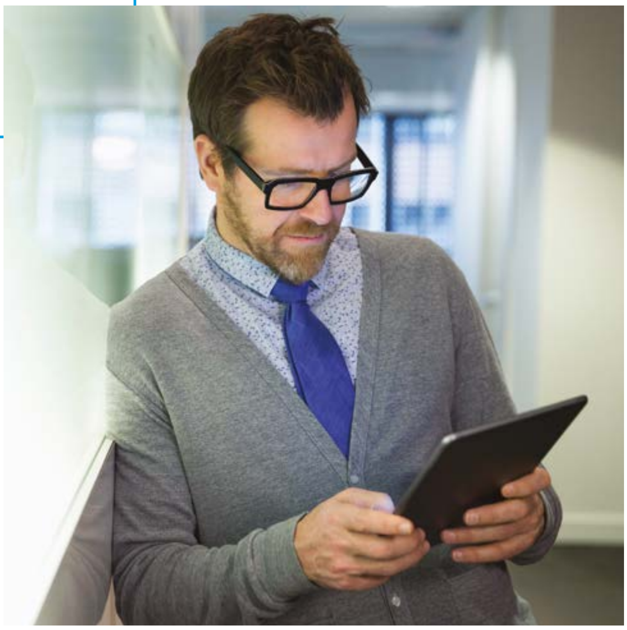
During another research activity (the review of integrated reports) researchers collected a sample of reports, published by listed companies in 2012–13, that were either called integrated reports or based at least in part on the principles of <IR>. The IIRC published the International <IR> Framework in December 2013 (IIRC 2013b) following a Consultation Draft on the Framework issued in April 2013 (IIRC 2013a). Principles for <IR> have been developing over many years. <IR> has its roots in financial reporting, management commentary reporting, remuneration reports and sustainability reporting.

The reports were sourced from the <IR> Business Network and <IR> Examples Database (IIRC 2014) and the Johannesburg Stock Exchange (JSE) listed

1 At the time of the interviews, the pilot programme's name had changed to the current title of *<IR> Business Network*.

> Decisions about materiality were influenced by a number of reporting frameworks, including statutory requirements (eg company law and accounting standards) and voluntary frameworks.

companies in the FTSE/JSE All-Share Index, where <IR> is required on a 'comply or explain' basis. The disclosures provided in the reports about companies' materiality determination processes were then reviewed. The aim of this activity was to gather information from public disclosures about how companies determine whether items are material and should therefore be disclosed in an integrated report. This step



shows the extent to which companies explain the process and provide disclosure of material items and illustrates, to some extent, how companies respond to the need for conciseness in reporting through the use of text, tables, figures and graphs.[2]

The third research activity sought to obtain insights from report preparers and auditors about how some specific factors influenced their judgements of whether items were material for disclosure purposes. The factors investigated were the magnitude and likelihood of items and whether a particular type of information (for example, financial, social or environmental information) was more likely to be considered material. By including these different types of information, aspects of some of the capitals in <IR> were explored, namely financial, human, natural and to some extent, social and relationship capital.[3]

1.3 RESEARCH QUESTIONS AND FINDINGS

The main research questions of the study are presented below, followed by the findings.

Question 1

How do integrated report preparers determine which disclosures are material for report users and therefore should be included in the report?

Interviews with corporate report preparers indicated that many companies had a specific process for identifying material matters and deciding what to disclose in their reports. The process commonly involved consultation with external and internal stakeholders. Many techniques were used, including surveys, interviews and focus groups. The process generally involved many staff throughout the organisation, across different divisions and levels, eventually leading up to the final disclosure decisions by the chief executives and board.

Decisions about materiality were influenced by a number of reporting frameworks, including statutory requirements (eg company law and accounting standards) and voluntary frameworks such as the GRI guidelines. It is worth noting that the International <IR> Framework and other reporting or regulatory frameworks are not mutually exclusive. The Framework states that 'an integrated report may be prepared in response to existing compliance requirements. For example, an organization may be required by local law to prepare a management commentary or other report that provides context for its financial statements. If that report is also prepared in accordance with this Framework it can be considered an integrated report. If the report is required to include specified information beyond that required by this Framework, the report can still be considered an integrated report if that other information does not obscure the concise information required by this Framework.' (IIRC 2013b: 1.14). There was some contribution by consultants (particularly on stakeholder engagement) and auditors. Legal advisers and auditors were mentioned fewer times than expected, possibly because many interviewees focused on the voluntary

2 The principles of conciseness would be applied to the whole report, not just the part examined here (the materiality determination process). Therefore, this study provides only a partial indication of how companies may have responded to the need for conciseness.

3 Neither manufactured nor intellectual capital is included (IIRC 2013b: 11–12).

> The evidence from the interviews suggests that many companies may have a specific process for determining when relevant items are material and for evaluating and prioritising these items.

nature of <IR> and the present freedom companies enjoy in relation to it. Many companies noted that they were still producing multiple reports to meet various national legal reporting obligations.

The materiality determination process appeared to develop over time (throughout the year) and to evolve with changes in the company and operating environment. The current practices of some of the companies are aligned with the process outlined in the Framework. Some companies used specific techniques, such as determining a materiality matrix or measuring, weighting and ranking key performance indicators (KPIs). The focus of identifying matters that may affect value creation appears to be reflected in interviewees' discussion of financial matters, company strategy and risk. Many insightful comments on these matters were provided by interviewees. They are included in Chapter 5.

Question 2

How do integrated report preparers achieve conciseness in the report?
During the interviews, corporate report preparers explained a number of techniques they used to achieve conciseness. First, many made use of their process for determining material items, such as consultation with stakeholders, to help them focus on material matters only. Second, they were strict about content, both as regards the length of the report (number of pages) and the topics included. For each topic, they focused on presenting the most relevant and important information. Third, they used presentation techniques (the report's layout, interrelationship of sections, and cross-referencing within the report and to additional materials on their website) to promote readability and to ensure only the most material information was actually included in the report.

The International <IR> Framework suggests ways in which companies can achieve conciseness. Comments from interviewees indicated that several companies appeared to be making use of many of these techniques. Specific comments from interviewees are provided in Chapter 3.

Question 3

To what extent do companies' integrated reports disclose their materiality determination process?
The International <IR> Framework provides guidance about how to determine whether an item is material. The Framework refers to four steps: (1) identifying relevant matters on the basis of their ability to affect value creation; (2) evaluating the importance of relevant matters for their known or potential effect on value creation; (3) prioritising matters on the basis of their relative importance; and (4) determining what information to disclose about material matters (IIRC 2013b: 18). The corporate reports of 252 companies included in the <IR> Business Network and <IR> Examples Database or listed on the Johannesburg Stock Exchange were reviewed. Of these:

- only 136 companies provided a description of the materiality-determination process; of these 136 companies, the majority (89%) explained how they identified relevant matters and
- a large proportion (75%) disclosed the material items, which suggested they had attended to steps one and four in the Framework.[4]

Even so, disclosures about the evaluation process used and the prioritising of material items, steps two and three in the Framework, were provided by fewer than one-quarter of companies (23% and 19%, respectively).

The evidence from the interviews suggests that many companies may have a specific process for determining when relevant items are material and for evaluating and prioritising these items. Nonetheless, the review of corporate reports showed relatively poor levels of disclosure about the more sensitive matters of how companies decide whether items are material and how they rank items on the basis of materiality. In addition, some integrated reports appear to be still in a transition phase from sustainability reports to integrated reports. Reports that draw on the GRI guidance for determining materiality may need further development in order to meet the goals and objectives of the International <IR> Framework.

4 We acknowledge that there is a difference between the disclosing of material items and describing the process by which the company determines what information to disclose (ie step four).

This review suggests that users of corporate reports may be well informed by some companies who have begun a journey toward integrated reporting because several companies provide general information about their stakeholders and they identify material items. By contrast, those looking for more specific information about the evaluation and prioritisation of material matters and how they link to value creation may be disappointed by the disclosures of some companies. All public disclosures, particularly those that could affect company value, are managed carefully by companies for legal and competitive reasons. Consequently, it is not surprising that there are relatively few disclosures about the evaluation and prioritisation of material matters among companies experimenting with <IR>.

The review of materiality disclosure provided some insights into how companies are achieving conciseness in reporting, and this builds on the information provided by the interviewees. The companies studied made use of various combinations of text, tables, figures and graphs. Figures are pictorial representations such as a materiality matrix or 'heat map' allow a large amount of information to be presented in a concise way and can also show the relative importance of various items. Chapter 4 provides several examples, including Figures 4.3 and 4.5.

The review of materiality disclosure provided some insights into how companies are achieving conciseness in reporting, and this builds on the information provided by the interviewees.

Question 4

How do the magnitude and likelihood of an item of information affect report preparers' and auditors' judgements about its materiality?

The International <IR> Framework states that the magnitude of an item and its likelihood of occurrence will assist people in determining whether a relevant matter is material. Magnitude and likelihood were seldom explicitly mentioned by interviewees or in the corporate reports examined but it seems reasonable to assume that the concepts underpin the process of determining materiality. The results of the behavioural experiment with 96 corporate report preparers and company auditors confirmed this assumption. The study shows that the greater the magnitude and likelihood of an item the more likely it is to be considered material. Participants were more confident about their judgements for items where both magnitude and likelihood were high (or both were low). For items where magnitude and likelihood were mixed (one high and one low), magnitude dominated likelihood when the two concepts interacted.

Question 5

To what extent does the type of item of information (for example, financial, social or environmental) affect report preparers' and auditors' judgements about the materiality of the item?

Some evidence indicated that financial items (ie items that will appear in the financial statements – Statement of Financial Position or Statement of Comprehensive Income) were more likely to be considered material than social and environmental items, which is consistent with a conventional interpretation of value as a monetary concept, one that generates shareholder returns, for example. In addition, this research suggested that people's perceptions of an item's magnitude and likelihood were more important for financial items than for other items. This tendency was more pronounced for participants whose current work role was as a preparer of financial statements compared to those working as external auditors.

The first finding may reflect the training and experience of preparers and auditors that causes them to focus on the materiality of financial items. It may also reflect the fact that value creation is often tied to the historical, financial impact of items, that is, the items that are measured and quantified in the company's accounts. This result may change in the future as companies expand their ability to quantify non-financial items and to measure their impact on value creation in the short, medium and long term.

The second finding suggests that auditors evaluate the materiality of all items and are likely to consider non-financial items equally with financial items because they have the potential to affect the future viability of a company. Another way of interpreting the results is to conclude that preparers see the financial items as more closely linked to value creation.

This study adds to prior literature by reporting the views of people who are leading practice in <IR>, and by comparing and contrasting their views with a review of the content of disclosure about materiality in publicly available company reports.

1.4 STRUCTURE OF THE REPORT

The following sections of this report present detailed descriptions of the research activities and findings. Chapter 2 presents a literature review that provides background about the development and emergence of <IR> and points to relevant academic studies. Chapter 3 presents information gathered from the interviews with preparers with experience of <IR>; this section provides many insights into the impact of materiality and conciseness on companies' disclosure decisions. Chapter 4 discusses the data collected from publicly available corporate reports about companies' materiality determination processes and summarises the findings from this data. Chapter 5 provides evidence of how the characteristics of relevant matters (eg their magnitude and likelihood; and the type of information, such as financial, environment or social) affect the materiality assessments of report preparers and auditors. Chapter 6 concludes the report by discussing challenges for <IR> and presenting possible future responses to these challenges. It also discusses how the study's findings add to previous literature in the area. Finally, there is a reference list. Two appendices provide supporting materials used in the study (ie the interview questions, the themes and subthemes used in coding the interviews, and the coding rules for the corporate reports).

1.5 CONTRIBUTION

This study adds to prior literature by reporting the views of people who are leading practice in <IR>, and by comparing and contrasting their views with a review of the content of disclosure about materiality in publicly available company reports. Interviewees were from 10 countries whereas earlier studies have concentrated on single countries. The review here of reporting practices on materiality disclosure adds understanding of the content of <IR>. It focuses on the key <IR> concepts of materiality and conciseness in disclosure.

A behavioural experiment exploring professional accountants' views on magnitude and likelihood in materiality determination provides evidence about judgement and decision making on materiality for non-financial information and in <IR>. In all the areas reported, the evidence presented extends current knowledge on the topic and therefore should be of interest to companies engaged or planning to engage in <IR> and to other involved parties such as investors and other stakeholders, auditors, standard setters, regulators and government agencies.

2. Literature review

For most companies, producing an integrated report reflects a strategic management decision.

2.1 INTRODUCTION

The aim of this study is to gather evidence about how companies determine material matters and achieve conciseness in <IR>. Academic studies about <IR> are beginning to emerge but as yet they are few because adoption of <IR> is not widespread and only the South African Johannesburg Stock Exchange has incorporated <IR> in its Listing Rules on a 'apply or explain' basis. This limits the data available for academic studies.

For most companies, producing an integrated report reflects a strategic management decision. The information in the report will be influenced by a number of reporting frameworks, including listing rules, company law and accounting standards as well as the International <IR> Framework, which was published relatively recently, in December 2013 (IIRC 2013b). The reports may also be influenced by companies' past practices in relation to sustainability reporting and therefore the Global Reporting Initiative (GRI) Framework (GRI 2013a).

This section of the report presents a literature review to provide background for the empirical work discussed in Chapters 4, 5 and 6. It starts with an explanation of some of the theory and motivations for voluntary disclosure by companies in financial and other reports. This is followed by background to the development and emergence of <IR> with reference to recent studies in the area (sections 2.3, 2.4 and 2.5). Sections 2.6 and 2.7 address issues and studies relevant to the specific topic of materiality and conciseness in <IR>.

2.2 THEORY AND PRACTICE OF VOLUNTARY DISCLOSURE

The release of information by companies is a fundamental part of the operation of capital markets. Some information is provided in response to mandatory requirements, such as listing rules, company law and accounting standards. Other information is provided on a voluntary basis, in order to meet information needs of investors and others.

Healy and Palepu (2001) point to various explanations for disclosure based on

Corporate reports covering financial, sustainability and other matters (eg remuneration reports and strategic reports) have grown in length and complexity, leading to calls for a more holistic approach to reporting.

agency theory and addressing the problem of information asymmetry between providers and users of capital. The authors list several explanations for voluntary disclosure of financial and non-financial information related to capital market participation: for capital market transactions, corporate control contests, stock compensation, litigation, proprietary costs and management talent signalling. Many studies have investigated the extent to which companies provide non-financial disclosures in financial reports as well as in other reports, for example, balanced scorecard, triple bottom line, corporate social responsibility and sustainability reports. A range of topics are covered in these reports, including human resources, employee relations, community involvement, customers, environment and social responsibility (Othman and Ameer 2009).

Corporate reports covering financial, sustainability and other matters (eg remuneration reports and strategic reports) have grown in length and complexity, leading to calls for a more holistic approach to reporting the economic, environmental and social aspects of business (de Villiers et al. 2014). The concept of <IR> has emerged, particularly following the formation of the International Integrated Reporting Committee (now Council) in 2010. In most countries, preparers of financial reports can choose to provide an integrated report or to follow <IR> principles. In line with the research discussed above, companies' decisions about what information is to be disclosed, the presentational style of the disclosure and where it is located would be expected to reflect a cost-benefit trade-off that involves strategic decisions on the part of managers.

2.3 BACKGROUND TO <IR> AND EARLY ADOPTION

In general, research about integrated reporting is in its infancy (de Villiers et al. 2014). Some studies explore the background and reasons for interest in <IR> and give guidance for preparing integrated reports (KPMG 2012). Deloitte (2012) reports on <IR> practices in South Africa. ACCA (2011) reports on the quality of <IR> in public reporting of listed companies from the Australian Stock Exchange (ASX 50), concluding that significant change would be required before these listed companies were ready to adopt <IR>. GRI (2013b) reports on the sustainability content of early adopters of <IR> principles and outlines implementation issues faced by these pioneers.

Other authors have presented case studies to illustrate developments in practice. For example, Dey and Burns (2010) report on the experience at Novo Nordisk, an <IR> pioneer. The authors observe that the company believed that <IR> was part of a new way of management, which encompassed corporate governance, employee culture, new management tools and ways of measuring performance. De Villiers et al. (2014) explain the relationship between <IR> and other forms of reporting, such as balanced scorecard and sustainability reporting. They also report on the extent of adoption of <IR> principles in a range of countries.

In 2015, South Africa was the only country where <IR> was mandatory, on a 'comply or explain' basis, via the listing rules of the Johannesburg Stock Exchange (de Villiers et al. 2014). Van Zyl (2013) investigates the quality of reporting in the mandatory regime by reviewing the reports for 2010–11 of 23 listed companies claiming to provide an integrated report. She concludes that although many companies have claimed to be creating integrated reports, the level of integration is very low. Rensburg and Botha (2014) conducted a survey in South Africa. A group of 421 respondents (who were predominantly white males aged over 40 years) reported that integrated reports provided only supplementary information. Their main sources of financial and investment information were companies' annual reports and interim financial reports.

Solomon and Maroun (2012) provide a review of the impact of <IR> on social, environmental and ethical reporting for 2009 and 2011 for 10 major South African companies listed on the Johannesburg Stock Exchange. They find a significant increase in the number of sections in annual reports that include social, environmental and ethical information, with the same information repeated, at times excessively, throughout the reports. The annual reports from 2010/2011 were more likely to discuss 'stakeholder accountability' and 'stakeholder engagement' while the 2009 reports were 'aimed primarily at stakeholders' (Soloman and Maroun 2012:5).

The incentives for adopting <IR> principles and the outcomes of adoption will differ between companies and countries, reflecting individual managers' preferences, firm circumstances and the regulatory and governance structures in place in particular countries.

The current state of <IR> is not satisfactory to some critics. Flower (2015) argues that the IIRC has moved away from its principle objective, which, in his opinion, was to promote sustainability accounting. His reasoning is that the IIRC's concept of value is now 'value for investors' not 'value for society'. Further, he argues that the IIRC should have placed an obligation to report on harm inflicted on entities outside themselves (such as the environment) when there is no subsequent impact on the firm. Flower (2015) also questions whether the International <IR> Framework would influence corporate reporting practice when the Framework has no legal force.

2.4 <IR> AND INSTITUTIONAL SETTING

The incentives for adopting <IR> principles and the outcomes of adoption will differ between companies and countries, reflecting individual managers' preferences, firm circumstances and the regulatory and governance structures in place in particular countries. In this vein, Frías-Aceituno et al. (2013) investigate the extent to which producing 'integrated' reports is associated with particular country characteristics, using a sample of 750 companies from 20 countries in the years 2008 to 2010. The authors' definition of integrated reporting was based on whether a company provides all its information (financial, management commentary, governance, remuneration and sustainability) in one document.[5] They conclude that companies in civil law countries and in countries where law and order are more strongly enforced were more likely to provide 'integrated' reports.

Jensen and Berg (2012) use a different approach, based on identification by scholars and prize-awarding organisations, for identifying companies with integrated reports. In 2008, using a sample from 43 countries of 309 companies that provided either integrated reports or sustainability reports,[6] they find that the providers of integrated reports are more likely to come from countries with stronger investor protection laws, higher levels of economic and environmental and social development, higher levels nationally of corporate responsibility and stronger value systems.[7]

2.5 <IR> IMPLEMENTATION ISSUES

Cheng et al. (2014) highlight a number of issues relating to the further development and implementation of <IR>. They report concerns about the focus on providers of financial capital in the International <IR> Framework, the meaning of the overall stock of capitals, trade-offs between capitals, and the ways in which assurance is provided for integrated reports. Van Bommel (2014) provides further insights about these concerns. He investigates impediments to implementation using documentary analysis and 64 interviews with people involved in <IR> in the Netherlands (managers, investors, standard setters, accountants, staff from civil society and non-government organisations). His particular interest lies in exploring impediments to developing a meaningful and legitimate form of accounting for sustainability that is integrated with corporate reporting on financial information. He identifies both complexities and potential in <IR> and describes the compromises being made by those involved in implementation and advancing practice in <IR>. Van Bommels (2014) suggests that there is a risk that <IR> may be captured by accountants and investors rather than being developed to meet a range of stakeholders' needs.[8]

Interviews conducted by Higgins et al. (2014) revealed that managers could have diverse views about the goals of <IR>. Higgins et al. conducted interviews with 23 Australian managers from 15 companies that were involved in early adoption of <IR>. They show that managers reported two main views of <IR>. One view is that <IR> is about telling the company's story and the other, which may be held simultaneously, is that <IR> is about meeting expectations of a range of parties external to the company. Some interviewees indicated their expectation that the tension between these views would resolve over time.

Also considering implementation issues, Haller and van Staden (2014) examine the question of how best to present information in an integrated report. They conclude that a value-added statement

5 Thus, the authors' definition is not compatible with the IIRC's definition of <IR> as presented and discussed in this report.

6 We again note that the authors' definition is not compatible with the IIRC's definition of <IR> as presented and discussed in this report.

7 'National corporate responsibility' was measured following Kolk and Perego (2010) using AccountAbility measures. Data on value systems was taken from Inglehart and Baker (2000) and Inglehart (2008).

8 However, the International <IR> Framework (2013b: 4) expressly states that while the 'primary purpose of an integrated report is to explain to providers of capital how an organisation creates value over time', the integrated report 'benefits all stakeholders interested in an organization's ability to create value over time, including employees, customers, suppliers, business partners, local communities, legislators, regulators and policy makers'.

Some researchers view <IR> as a potential innovation in corporate reporting.

would be a 'practical, effective, efficient as well as reliable and useful reporting instrument that complements and represents the concepts of <IR>' (Haller and van Staden 2014: 1191). The authors argue that the value-added statement could capture the wealth creation of the company through its business activities as well as value distributed to major stakeholders of the company. A limitation could be that the statement is based on values that are presented in monetary terms, but this could be offset by presenting the value-added statement as one of several components in an integrated report.

Some researchers view <IR> as a potential innovation in corporate reporting. Therefore, it is appropriate to ask questions about how following <IR> principles changes practice. Stubbs and Higgins (2014) pose the question: to what extent does <IR> stimulate innovative disclosure practices? They interviewed 23 managers from 15 Australian companies that were engaged in some way with producing integrated reports. The authors report that these organisations were changing their processes and structures but their adoption of <IR> principles had not, thus far, stimulated new innovations in disclosure mechanisms. The authors do not find radical change to reporting processes but rather incremental changes to the processes and structures that previously supported sustainability reporting.

2.6 MATERIALITY AND CONCISENESS IN FINANCIAL REPORTING

Materiality is a fundamental concept in financial reporting. It is described in the IASB's *Conceptual Framework for Financial Reporting* (2010a) as an entity-specific aspect of relevance. Paragraph QC11 states that information is material 'if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity'.[9] Conciseness is not a concept included in the Conceptual Framework. Application of the fundamental (relevance and faithful representation) and enhancing (comparability, verifiability, timeliness and understandability) qualitative characteristics do not provide any particular guidance on conciseness in reporting.

The concept of materiality for financial reporting purposes is well established and widely used by accountants, auditors and users of financial reports (Adams and Simnett 2011). Accounting standards define materiality as: 'Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions users make on the basis of the financial statements' (IASB: IAS 1 *Presentation of Financial Statements,* paragraph 7). It is worth noting that for the purposes of the IASB's Conceptual Framework, the primary users of the financial statements are defined as: 'present and potential investors, lenders and other creditors, who use that information to make decisions about buying, selling or holding equity or debt instruments and providing or settling loans or other forms of credit.' (Conceptual *Framework for Financial Reporting*, 2010a, paragraph OB2). This standard also states that materiality depends on the size or nature of the omission or misstatement, judged in the surrounding circumstances. The size or nature (or both) of an item could determine whether an item is material.

Messier et al. (2005) review studies about auditors' materiality judgements in the context of financial statements. They conclude that the percentage effect of an item on income was the single most important quantitative factor in determining materiality. Krogstad et al. (1984) show that, although the auditors they studied focused primarily on the effect of the item on net income, they also used non-financial information. The impact of non-financial cues was considerably less than the effect of net income, and there was a lack of agreement about which non-financial cues were important in the context of financial reporting. Similarly, Bernardi and Arnold (1994) conclude that qualitative factors influence financial statement auditors' materiality decisions.

In relation to the importance of materiality for users of financial reports, Haka et al. (1986) show that magnitude of financial items (sales, costs) is positively associated with materiality judgements. Carpenter and Dirsmith (1992) show that in addition to magnitude, the nature of a transaction affects users' materiality judgements in the context of financial reporting. They

9 The IASB Exposure Draft of the revised Conceptual Framework for Financial Reporting defines material as: 'Information is material if omitting it or misstating it could influence decisions that the primary users of general purpose financial reports […] make on the basis of financial information about a specific reporting entity' (para 2.11) (IASB 2015a).

Reporting in a concise way about a large international business with numerous stakeholders and areas of operations can be a challenge.

conclude that qualitative contextual information has been used to augment the qualitative assessment of materiality.

As previously noted, conciseness is not a concept used in the IASB Conceptual Framework. Nonetheless, a focus on relevance should, in theory at least, encourage report preparers to be concise

in their presentation of information. In recent times, there has been strong criticism that financial reports have become too large and complex to be useful. In addition, there have been calls for more focus on materiality to reduce irrelevant disclosures (FRC 2011).

The IASB has responded to these criticisms through work on the Disclosure Initiative, which includes the release of an Exposure Draft *Practice Statement on the Application of Materiality to Financial Statements* (IASB 2015b). The objective of the project is to help preparers, auditors and regulators use judgement when applying the concept of materiality. IAS 1 has been amended to give more guidance about materiality and disclosure requirements and to discourage overly prescriptive interpretations of these requirements (IASB 2014). The outcome of greater emphasis on materiality should be more relevant and potentially more concise financial reports.

Nevertheless, some forces act against achieving conciseness in reporting. Companies are sensitive to the need to meet all their various reporting obligations fully and may have concerns about the litigation risk arising from non-disclosure of information. Business operations are complex and companies have many stakeholders, outside of the IFRS definition of primary users, with different information needs. Reporting in a concise way about a large international business with numerous stakeholders and areas of operations can be a challenge.[10] In addition, a checklist approach and the need to avoid litigation also contribute to a tendency towards over-disclosure amongst auditors as well as preparers.

2.7 MATERIALITY AND CONCISENESS IN INTEGRATED REPORTS

The primary guidance on materiality and conciseness in <IR> comes from the International <IR> Framework, as discussed in Chapter 4 of this report. Other guidance on the topic comes from the IIRC documents that preceded the issue of the Framework (IIRC 2013a) and publications from professional accountancy firms (AccountAbility 2006; EY 2013). To date there is little published academic research on materiality in <IR>, and the present study adds to the following papers.

Solomon and Maroun (2012) report an increased focus on materiality in annual reports of 10 South African companies over the period 2009 to 2011. They show that these companies highlighted the social and environmental issues they considered material. They did not, however, explain in detail how the materiality decision had been made or what materiality means in the company's context. After completing interviews with managers from Australian companies that were early adopters or partial adopters of <IR> practices, Stubbs and Higgins (2014) report that managers had a process for identifying material issues. Further, these companies were attempting to align the materiality determination process with their business strategy. Some companies were moving away from sustainability reporting guidelines (such as the Global Reporting Initiative (GRI)) to focus on more strategic issues rather than the multitude of items included in GRI.

10 We are aware that conciseness is a relative concept. For example, the length of a report deemed concise for a large international conglomerate is likely to be excessive for a smaller or more simple organisation. However, we are also aware that there is a tendency for users to dismiss the complexity of the company when assessing the conciseness of the report.

> While there are several studies about materiality in traditional financial statements audit engagements, there has been less investigation of the topic for other assurance engagements.

While there are several studies about materiality in traditional financial statements audit engagements, there has been less investigation of the topic for other assurance engagements. Moroney and Trotman (2015) explore auditors' materiality judgements for a financial audit compared with those for a sustainability (water) assurance engagement. They show that auditors assess an audit difference[11] as significantly more material for the financial engagement. They also consider the effect of qualitative factors (risk of breaching a contract, likelihood of community impact) on auditors' judgements and conclude that qualitative factors have more impact when assessing sustainability.

Cheng and Green (2015) also investigate auditors' materiality judgements on non-financial performance information. They consider two cases: when the client's performance measurement system contains strategic linkages and when it does not. The authors find that auditors consider misstated non-financial performance information of low strategic relevance to be less material than misstated non-financial performance information of high strategic relevance but only when the client's performance system contains strategic linkages. The authors conclude that their evidence suggests that the materiality of non-financial information will be determined in relation to an organisation's strategic objectives.

2.8 CONCLUSION

This chapter has discussed literature that is relevant to understanding the development of <IR> and in particular materiality and conciseness in <IR>. Recent studies have investigated various <IR> implementation issues by reporting on practitioners' experiences as early adopters of <IR> principles. Case studies and interviews with practitioners have provided valuable insights into implementation issues. Researchers have also extended studies of judgements about materiality to encompass matters relevant to <IR>.

The present study adds to the existing literature in a number of ways. First, the study adds to evidence from interviews with early adopters in single countries about their <IR> experiences (Higgins et al. 2014; Stubbs and Higgins 2014; van Bommel 2014). The present study focuses on materiality; managers from 10 countries were included in the interview sample. Second, there are few studies of corporate reports produced by companies that state they are following <IR> principles. Information is provided here about the format of reports being produced by early adopting companies in 28 countries, along with evidence about the materiality determination process, as described in corporate reports. This complements both the interviews conducted for this research and those of Stubbs and Higgins (2014). A third area of contribution relates to research on human judgement and decision-making. This study complements other work that explores judgements about the materiality of non-financial information and materiality in <IR> (Cheng and Green 2015; Moroney and Trotman 2015). More details about the authors' research activities and evidence is provided in Chapters 3, 4, and 5 of this report.

11 A difference in the views of the auditor and the client, regarding the experimental item (set at 6.6% of the relevant underlying base item). That is, participants were asked if failure to correct the audit difference would make the financial statement or report materially misstated.

3. Materiality and conciseness – views of preparers

<IR> is defined as 'a process founded on integrated thinking that results in a periodic integrated report by an organisation about value creation over time and related communications regarding aspects of value creation' (IIRC 2013b: 33).

3.1 INTRODUCTION

<IR> is defined as 'a process founded on integrated thinking that results in a periodic integrated report by an organisation about value creation over time and related communications regarding aspects of value creation' (IIRC 2013b: 33). An integrated report is defined as a 'concise communication about how an organization's strategy, governance, performance and prospects, the context of its external environment, lead to creation of value over the short, medium and long term' (IIRC 2013b: 33).

The International <IR> Framework states that materiality and conciseness are underlying principles of <IR>. According to the Framework, 'a matter is material if it could substantively affect the organization's ability to create value over the short, medium or long term' (IIRC 2013b: 33). The Framework also states that an integrated report should be concise (IIRC 2013b: 18), that is, 'include sufficient context to understand the organization's strategy, governance, performance and prospects without being burdened with less relevant information' (IIRC 2013b: 3.37).

A series of interviews with representatives of companies that are engaged in developing integrated reports yielded insights into how they are responding to the call to provide material information in a concise way. There were 15 interviews with staff of companies who had extracts of their reports included in the IIRC's <IR> Examples Database or were members of the <IR> Business Network. The findings of the interviews are relevant to the first two research questions listed in Chapter 1:

Question 1
How do integrated report preparers determine which disclosures are material for report users and therefore should be included in their reports?

Question 2
How do integrated report preparers achieve conciseness in their reports?

> The target interviewee companies were those with experience with <IR> and the target employees in those companies were people involved in the corporate reporting process, in either the investor relations or financial reporting sections of the companies.

3.2 RESEARCH METHOD

Ethics committee approval was obtained from the University of Western Australia for conducting the interviews using the set of questions set out in Appendix A1. The target interviewee companies were those with experience with <IR> and the target employees in those companies were people involved in the corporate reporting process, in either the investor relations or financial reporting sections of the companies. Two pilot interviews were conducted with senior executives whose companies have been leaders in corporate reporting. One researcher took the primary interviewer role in both interviews, to ensure consistency in the way the questions were asked. Another researcher participated in the interviews to provide feedback to the primary interviewer about the questions and the conduct of the interview. Following this process, the research team added one question to the set of interview questions and refined the notes about the information the interviewer was seeking to draw out through the questions.

Using the list of companies who had extracts of their reports included in the IIRC's <IR> Examples Database or were members of the <IR> Business Network, the investor relations sections of companies were contacted by email to explain the purpose of the study and to request a telephone interview. Subsequently, interviews were arranged with the first 15 companies who responded. All interviewees were assured of confidentiality for their responses to promote full and frank discussion in the interviews.

The interviews were recorded and transcribed during the period December 2014 to February 2015. The evidence provided by the interviews is largely anecdotal because the sample of companies included is not a representative sample of the population of their country of domicile (or operations) or industry sector. Nevertheless, the interviewees were from a range of industries, countries and regions, suggesting that their comments are likely to capture broad international experience. Interviewees were from 15 companies, representing six industry sectors (financial services, technology, industrials, basic materials, utilities and healthcare) and 10 countries (representing North America, the Asia-Pacific region, Europe and Africa). Commenting on interview methodology, Guest et al. (2006) report that themes emerge by around the sixth interview and saturation point is often reached at around the twelfth. The primary interviewer for the current project observed that common threads in answers to questions began to emerge after the fifth or sixth interview.

Table 3.1: Job roles of interviewees

Ref	Position/job title	Sector	Country
IR1	Senior Manager Corporate Communications	Basic Materials	Australia
S1	Manager Sustainability Reporting[a]		
CF1	Executive General Manager of Finance	Financials	Australia
CF2	Managing Director & Head of Tax and Accounting Policy	Financials	Singapore
CF3	General Manager – Financial Control	Financials	Australia
IR2	Corporate Communications Manager[a]		
CF4	Corporate Finance and Strategy	Industrials	Sri Lanka
CF5	Corporate Professional Technical Accounting and Financial Reporting	Utilities	South Africa
IR3	Head of Investor Relations	Technology	United Kingdom
IR4	Investor Relations Manager	Industrials	United Kingdom
IR5	Investor Relations	Technology	Germany
IR6	Manager Investor Relations	Industrials	Netherlands
S2	Sustainability Officer	Financials	Netherlands
S3	Project Manager Corporate Social Responsibility	Industrials	Netherlands
S4	Senior Associate, Accountability Reporting	Financials	Canada
S5	Corporate Sustainability	Healthcare	Denmark
S6	Manager Sustainability & Internal Communication	Technology	Spain

[a] During these interviews, two representatives from the same company participated at the interview. In both instances, the responses can be attributed to the individuals.

> The interviews provided a rich source of data about the experience of companies involved in producing integrated reports or working towards making their corporate reports more integrated.

The interviewees (17 in total, representing 15 companies) were managers from departments involved in external reporting. Five were from corporate finance divisions, six were from corporate communication or investor relations divisions and six were from sustainability (or corporate social responsibility) divisions (see Table 3.1). Interviewees were very knowledgeable on the topic of corporate reporting, as shown in the material presented in section 3.3 below. All were experienced in many facets of corporate reporting and had some involvement in <IR>. The interviewees were from companies that are leading and innovating in <IR>. Their comments reflect their experience and cannot be assumed to be representative of companies in general, including those not involved in <IR>.

Interviews were transcribed and checked for accuracy by two of the chief researchers. Next, the interview transcripts were analysed by two members of the research team using the following procedure. First, each person worked independently to identify themes and subthemes within the interview, by reading and coding three interviews. The two researchers then compared their lists of themes and subthemes and agreed upon a final list for coding, which they then applied to the three interviews (see Appendix A2 for the list of themes and subthemes). Next, the researchers compared their final coding of the three interviews. Any discrepancies in coding were discussed and reconciled. In this way, the researchers were able to agree on the classification and interpretation of the comments provided in the interviews. Following this step, each researcher proceeded to code the remaining interviews.

The independent coding followed by checking and reconciliation between coders served to increase the reliability of the coding process and improve the validity of the data extracted from the interviews. When coding was completed, data was summarised into tables of themes and subthemes for further analysis, as discussed in section 3.3 below.

3.3 INTERVIEW FINDINGS

The interviews provided a rich source of data about the experience of companies involved in producing integrated reports or working towards making their corporate reports more integrated. Six interviewee companies had produced one or more reports they called an integrated report and the other nine companies were in the process of developing an integrated report, described by one interviewee as being 'on a journey towards <IR>' (CF2).

3.3.1 Producing an integrated report

For many companies, the process of issuing or developing an integrated report has occurred over time, usually involving management and staff throughout the company and reflecting the influence of a large number of reporting frameworks. Figure 3.1 depicts the interaction of these frameworks, which include: company law, accounting standards, requirements for narrative reports contained in company law or guidance documents such as the IASB Management Commentary Guidance Statement (IASB 2010b), the GRI Framework (GRI 2013a), the International <IR> Framework and AA 1000 AccountAbility Principles Standard (AccountAbility 2008). The frameworks that interviewees most commonly mentioned as important for <IR> were the International <IR> Framework and the GRI Framework. At the time of the interviews, the influence of the International <IR> Framework is best described as partial. For example, one interviewee stated:

> 'We have made steps towards integrated reporting. I don't think we have issued or published an integrated report yet, in accordance with the framework, but we did incorporate elements of integrated reporting into our annual report'.

Interviewees also explained how <IR> had evolved or was still evolving. Commonly, integrated reports were being produced by revising the content of another report, such as the annual report. Other interviewees mentioned combining the annual report and the sustainability report to produce an integrated report. Many companies are also preparing and filing statutory documents to meet regulatory requirements in their home country and in relation to their stock exchange listings (eg in the US). Other specific reports are still prepared by some companies, for example, a remuneration report or corporate governance report. One interviewee stated: 'For the traditional corporate reporting document, we produce our year-end financial statements…we also try to expand that document, instead of just having it be a statutory requirement, we try to use to it to satisfy integrated reporting [requirements] as well' (IR4).

Within any company, managers and staff from many sections or divisions are likely to be involved in the preparation of corporate reports, including an integrated report.

Within any company, managers and staff from many sections or divisions are likely to be involved in the preparation of corporate reports, including an integrated report. Figure 3.2 depicts the parties who are influential. They include the board of directors, board committees (such as the audit committee) and senior executives. Often, several areas of the company are involved, including finance, treasury, investor relations, sustainability and the operating divisions. In addition, there are people external to the company who may influence the content of the integrated report. They include auditors and legal advisers, regulatory agencies and government bodies. Other external stakeholders include shareholders, investors, customers and employees.

3.3.2 Determining materiality

The International <IR> Framework provides guidance about how to determine whether an item is material. The Framework refers to four steps: identifying relevant matters on the basis of their ability to affect value creation; evaluating the importance of relevant matters in terms of their known or potential effect on value creation; prioritising matters according to their relative importance; and determining the information to disclose about material matters (See Table 3.2).

Figure 3.1: Frameworks influencing evolution of <IR>[12]

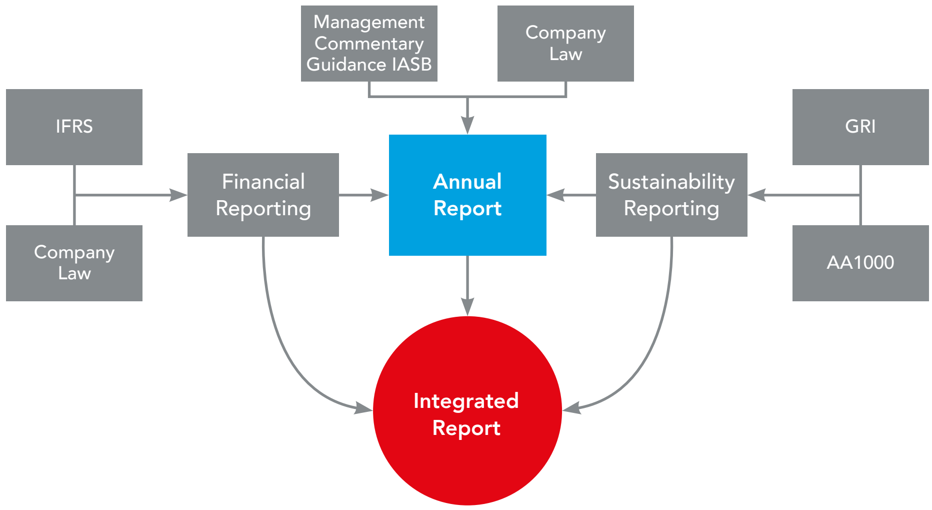
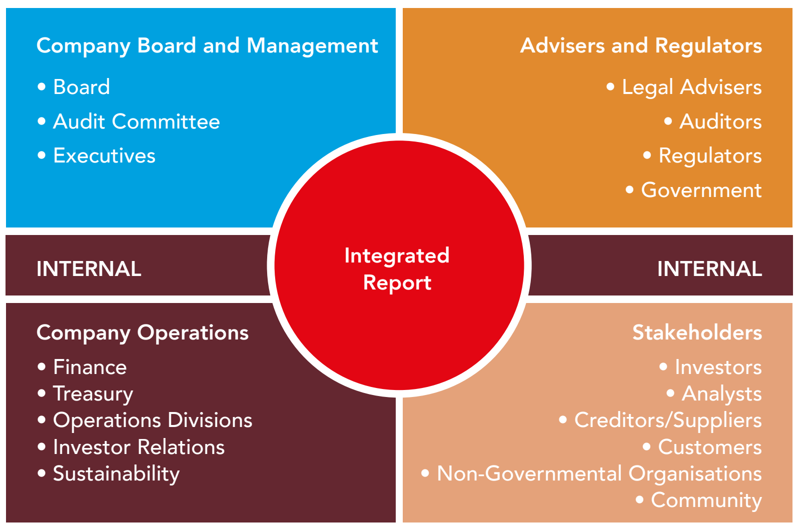


Figure 3.2: Internal and external participants in <IR>



12 In addition to GRI = Global Reporting Initiative see www.globalreporting.org/reporting/reporting-framework-overview/Pages/default.aspx and AA1000 = AccountAbility see www.accountability.org/standards, reference was also made to other sustainability frameworks/guidelines for the preparation of sustainability reports, including: SASB = Sustainability Accounting Standards Board see http://www.sasb.org/, ISO 26000 = International Organization for Standardization see http://www.iso.org/iso/home/standards/iso26000.htm, and CDSB = Climate Disclosure Standards Board see http://www.cdsb.net/what-we-do/reporting-frameworks/climate-change.

Throughout the interviews, interviewees did not mention magnitude or likelihood even though the Framework refers to these terms as relevant to determining materiality.

Interviewees described a process for determining the content of their corporate reports. The process involved decisions about what information to disclose, including determining whether an item of information is material. An overview of how interviewees described the materiality determination process is provided in Figure 3.3, which shows the incidence in the transcripts of selected key words on the themes of 'content' and 'materiality'.

In the questions about the content of their reports and how they determine materiality (Questions 4 and 5 in the interview, see Appendix A1), interviewees referred most to 'materiality' and 'stakeholders' then 'financial', 'strategy' and 'risk' (Figure 3.3, blue bars). There was less discussion of 'judgement' and 'prioritise' than expected given the subjective nature of the task.

Considering the entire interview transcript for all interviewees, the commonly mentioned terms include 'materiality', 'stakeholders' and 'strategy' but 'financial' is more frequently referred to (second, after 'materiality') in the full interview compared with its incidence in answers to Questions 4 and 5 alone (How do you decide what is included in the report? How do you determine whether an item is material?) (Figure 3.3 red bars). Interviewees seldom referred to 'value creation' and 'capitals' in answering Questions 4 and 5, although they did discuss these concepts at other points in the interview. Throughout the interviews, interviewees did not mention magnitude or likelihood even though the Framework refers to these terms as relevant to determining materiality.

Table 3.2: International <IR> Framework Section 3D – The materiality determination process

Materiality determination Section 3D	International <IR> Framework	International <IR> Framework paragraph references
Identify	Identifying relevant matters on the basis of their ability to affect value creation as discussed in Section 2B (see paragraphs **3.21–3.23**)	**3.21** Relevant matters are those that have, or may have, an effect on the organisation's ability to create value. This is determined by considering their effect on the organisation's strategy, governance, performance or prospects. **3.22** Ordinarily, matters related to value creation that are discussed at meetings of those charged with governance are considered relevant. An understanding of the perspectives of key stakeholders is critical to identifying relevant matters. **3.23** Matters that might be relatively easy to address in the short term but which may, if left unchecked, become more damaging or difficult to address in the medium or long term need to be included in the population of relevant matters. Matters are not excluded on the basis that the organisation does not wish to address them or does not know how to deal with them.
Evaluate	Evaluating the importance of relevant matters in terms of their known or potential effect on value creation (see paragraphs **3.24–3.27**)	**3.24** 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. **3.25** Magnitude is evaluated by considering whether the matter's effect on strategy, governance, performance or prospects is such that it has the potential to influence value creation substantially over time. This requires judgement and will depend on the nature of the matter in question. Matters may be considered material either individually or in the aggregate. **3.26** Evaluating the magnitude of a matter's effect does not imply that the effect needs to be quantified. Depending on the nature of the matter, a qualitative evaluation might be more appropriate. **3.27** In evaluating the magnitude of effect, the organisation considers: quantitative and qualitative factors; financial, operational, strategic, reputational and regulatory perspectives; area of the effect, be it internal or external; time frame.
Prioritise	Prioritising the matters on the basis of their relative importance (see paragraph **3.28**)	**3.28** Once the population of important matters is identified, they are prioritised according to their magnitude. This helps to focus on the most important matters when determining how they are reported.
Disclose	Determining the information to disclose about material matters (see paragraph **3.29**).	**3.29** Judgement is applied in determining the information to disclose about material matters. This requires consideration from different perspectives, both internal and external, and is assisted by regular engagement with providers of financial capital and others to ensure the integrated report meets its primary purpose as noted in paragraph 1.7. (See also paragraphs 4.50–4.52.)

Source: IIRC (2013b: 18)

For companies that had prepared an integrated report, stakeholder engagement becomes 'an increasingly important business imperative' (ACCA 2011: 8).

Figure 3.4 shows the incidence in the transcripts of the selected words on the themes of 'content' and 'materiality' weighted by the number of times the word 'material(ity)' was used when answering Questions 4 and 5 (see Appendix A1).[13] Figure 3.4 illustrates the differences between companies that had produced one or more reports that they called an integrated report compared with those that, at the time of interviews, had not. Companies that produced an integrated report were more likely to discuss their content and materiality determination process in terms of 'strategy', 'risk' and 'stakeholders' than were companies in our sample that had not yet prepared an integrated report. Reference to these words could suggest companies' engagement with the guiding principles and content elements contained within the <IR> Framework. For companies that had prepared an integrated report, stakeholder engagement becomes 'an increasingly important business imperative' (ACCA 2011: 8). In comparison, companies that

Figure 3.3: Incidence of keys words on themes 'Content' and 'Materiality'

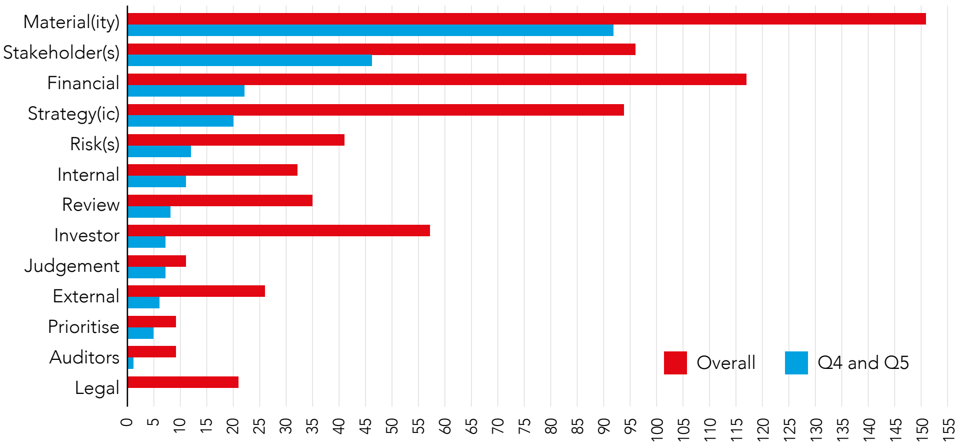


Figure 3.3 shows incidence of specific words in the interviewees' transcripts for the subthemes of Questions 4 and 5 (How do you decide what is included in the report? How do you determine whether an item is material?). Blue bars show the incidence for answers to Questions 4 and 5 only. Red bars show the incidence in the full interview.

Figure 3.4: Incidence of key words on the 'Content' and 'Materiality' themes weighted by 'Material(ity)' in questions 4 and 5

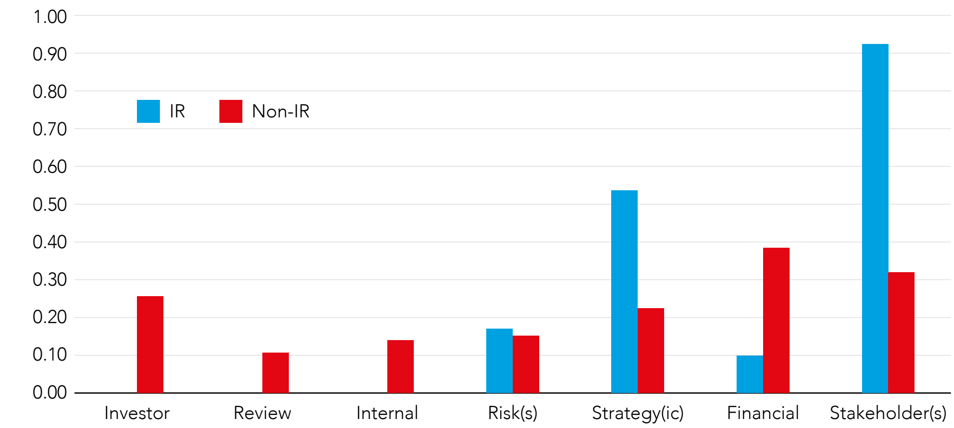


Figure 3.4 shows the incidence of the interviewees' use of words weighted by 'materiality' for the subthemes of Questions 4 and 5 (How do you decide what is included in the report? How do you determine whether an item is material?). Blue columns show the weighted word count for companies identified as having issued an integrated report. Red columns show the word count for companies that have not yet issued an integrated report.

13 That is, the graph shows a number between 0 - 1.00 which is calculated by dividing the number of times the word listed in the column in Figure 3.3 was used (numerator) by the number of times the word 'material(ity)' was used in answering Questions 4 and 5 (denominator). Thus, the numbers in Figure 3.3. are scaled to reflect the extent of discussion of the topic of materiality in each interview. This weighting of the scores serves to improve their comparability by controlling for the variation in level of discussion of materiality in each interview.

Many companies appear to have a clear process, involving a number of steps, for determining materiality.

had yet to prepare an integrated report referred more to the word 'financial'. This is consistent with past practice, as historically organisations have used financial measures to determine materiality (EY 2013).

One interviewee stated:

'There is no easy systematic way to determine materiality' (IR4).

Despite this, many companies appear to have a clear process, involving a number of steps, for determining materiality. A summary of the content of the interviewees' responses is set out below in the four bullet point lists. The key points from the responses are grouped under four headings representing the four steps of the International <IR> Framework – identify, evaluate, prioritise, and disclose (paragraph 3.21–3.29 as shown in Table 3.2). Therefore, the list below provides a succinct overview of the actions undertaken in companies as revealed by the interviewees. There is overlap between the four steps; for example, the process of identification can involve evaluation and the process of disclosure reflects the previous steps. In addition, the allocation of comments reflects the researchers' judgement; others may classify the comments differently.

Identify

- Conduct meetings or surveys of stakeholders (eg shareholders/ investors/ members/ employees/ customers/ peers/ government organisations/ regulators), many of whom are the 'external audience'.
- Ask stakeholders to prioritise topics, according to their importance to them.
- Engage consultants to collect data (eg through interviews or surveys).
- Conduct a media review to find material items.

Evaluate

- Create a materiality matrix that shows the importance of items to stakeholders on one axis and the important of the items to the company on the other axis.
- Weight items (eg some companies score items according to a number of dimensions to provide a ranking used to judge materiality).
- Compare data against targets such as key performance indicators (KPIs).
- Review reporting practices of peer companies and leaders in other sectors.

Prioritise

- Carry out internal review of the stakeholder feedback (eg the management group reviews the stakeholder feedback and evaluates the importance of the topics for the company).
- Use internal and external feedback to determine material items (eg consider the relationship of item to company strategy and value creation).
- Consider each item's relevance for this period, and whether relevance has changed.

Disclose

- Arrive at decisions about what is disclosed, and where, on the basis of the findings of the three previous steps.
- Take direction from management (leadership team, audit committee, board).
- Consider strategic risk and operational risk.
- Seek advice from consultants on disclosure.

Table 3.3 presents a series of quotes that further illustrate the wide range of factors that affect companies' decisions about materiality.

Table 3.3: Preparers' views – Factors affecting materiality judgements

Factors affecting materiality judgements	Comments from interviews
Identify	'To determine material items, we look at the importance to both stakeholders and those running our own business and what kind of impact it has on our ability to achieve our vision' (S4). 'For materiality, we first ask what is the impact on our company? Then we look at three things…will it have an impact on the decision-making of stakeholders? Is there a big risk to our company's business operations? And is the item so important that it can negatively impact the achievement of our strategic objectives?' (CF5). 'With materiality, we take a look at what impacts our business, so we have determined, for example, that employee engagement is material, because the brain power that we have in our employees is key to innovation and therefore to our success' (IR5). 'We involve internal and external people, and we pinpoint what the key, relevant topics are and important material aspects and we have validated this with the board' (IR6). 'We hire an independent, external consulting firm to conduct interviews with our stakeholders. Our stakeholders could be anything from customers and peers to government organisations and regulators. We ask them several questions about how they feel the information reported relates to their information needs and areas for improvement. But we also ask them to review a set of issues which we have come up with in terms of their importance to them as stakeholders' (S2). 'We come up with the issues by doing a pretty extensive media review of items for ourselves and the financial services sector in the press, in our main markets over the past year. We also look at items of other providers and other peers to see what they are looking at for material issues' (S2).
Evaluate	'We consult internally and externally to arrive at a materiality matrix which identifies issues and assigns weights to them' (S6). 'People from our CSR department, our financial department, our corporate risk manager and also our CFO sat together and we really started to talk about our value creation process and the structure of the report, what we wanted to report on what we didn't want to report on' (S3). 'The consultants set up a template which is called a connectivity table, many companies are using this. In this kind of a matrix; you put in your key stakeholders and the key material topics for your stakeholder groups; you put in the value drivers that are important for those material topics, your strategic objectives that are related to them, and the KPI's that you have attached to them. It's basically about seeing the relationship between your strategy and the value creation process' (S3). 'We review our materiality assessment – based on internal and external input – every few months. It's put forward to our sustainability committee of the board…who oversee our sustainability issues' (S1). 'I do an annual search for inspiration, looking at what the other companies are reporting, what are the trends' (S5).
Prioritise	'We prioritise the issues that are raised within the engagement. Then we combine them into different focus areas and then we draw out the issues to include in the report' (S1). 'We compare feedback about material items from our management committee and from the external review (feedback from stakeholders, media and competitors) to arrive at the items that we use as the basis of reporting' (S2). 'The materiality process feeds into a high level group that pulls in strategic risk assessment, operational risk and feedback from stakeholder engagement, whether through customer satisfaction surveys or stakeholder engagement workshops. All of those group functions come together and work on a prioritisation of how we create value over time and then we map that across a time period' (IR2).

> The Framework states that an integrated report should be concise, that is, have 'sufficient context to understand the organization's strategy, governance, performance and prospects without being burdened with less relevant information' (IIRC 2013b: 3.37).

3.3.3 Achieving conciseness

The International <IR> Framework calls for conciseness in reporting. The Framework states that an integrated report should be concise, that is, have 'sufficient context to understand the organization's strategy, governance, performance and prospects without being burdened with less relevant information' (IIRC 2013b: 3.37). Further guidance about conciseness is provided in paragraph 3.38 (see Table 3.4).

An overview of how interviewees explained achieving conciseness is provided in Figure 3.5, which shows the incidence in the transcripts of selected key words for the conciseness theme. In the question about how companies achieve conciseness (Question 6, Appendix A1) interviewees referred most to 'pages' followed by 'relevance', 'details' and 'risk'. Reference to 'pages' reflects discussion of concerns about the length of documents while 'relevance', 'details' and 'risk' refer in part to discussions about the risk of omitting relevant information (Figure 3.5, blue bars). Considering the occurrence of this same set of key words in the full interview transcripts for all interviewees, the most commonly mentioned words are 'regulation/framework', 'user/audience', 'risk' then 'pages' (Figure 3.5, red bars).

Table 3.4: International <IR> Framework Section 3E Conciseness

Conciseness Section 3E	International <IR> Framework	International <IR> Framework paragraph references
3.36 An integrated report should be concise	**3.37** An integrated report includes sufficient context to understand the organisation's strategy, governance, performance and prospects without being burdened with less relevant information.	**3.38** The organisation seeks a balance in its integrated report between conciseness and the other Guiding Principles, in particular completeness and comparability. In achieving conciseness, an integrated report: • applies the materiality determination process described in Section 3D; • follows a logical structure and includes internal cross-references as appropriate to limit repetition; • may link to more detailed information, information that does not change frequently (eg a listing of subsidiaries), or external sources (eg assumptions about future economic conditions on a government website); • expresses concepts clearly and in as few words as possible; • favours plain language over the use of jargon or highly technical terminology; • avoids highly generic disclosures, often referred to as 'boiler-plate', that are not specific to the organisation.

Source: IIRC (2013b: 21)

Figure 3.5: Incidence of key words on 'Conciseness' theme

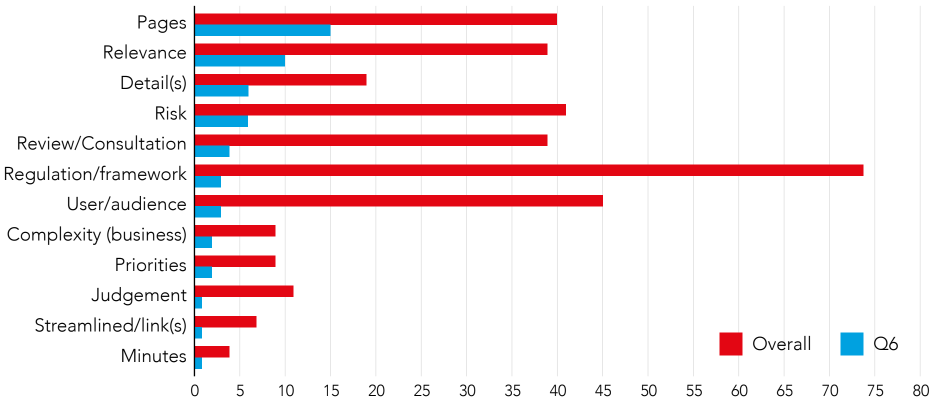


Figure 3.5 shows the incidence in transcripts of specific words for the subthemes of Question 6 (How do you achieve conciseness in your report?). Blue bars show the incidence for Question 6 only. Red bars show the incidence for the full interview.

> Conciseness is an incredible challenge because of all the guidelines and standards we must follow.

The incidence of the term 'conciseness' was further analysed in relation to whether the particular interviewee's company had or had not produced a report the company called an integrated report. No noticeable trends were found in the incidence for the two groups.

The interviewees made many comments on the theme of conciseness. The bullet point lists below provide a summary of the key points, under the headings of process (about the process used by companies to achieve conciseness in the report), structure (companies' reporting goals and the tools they use to achieve their goals) and judgement (matters requiring judgement to achieve conciseness).[14]

Process

- Identify areas to be covered and specific targets in each area.
- Use a specific process for making decisions about content (for example, a process for determining the materiality of items as discussed above).
- Apply general reporting principles: transparency, consistency, completeness and accuracy
- Undertake revisions and redrafting.

Structure

- Use clearly delineated separate sections in the report.
- Use a content index, to make a clear storyline.
- Avoid repetition by using links and cross-references.
- Achieve integration of content in various sections of the report.
- Create a high-level report, with links to additional information (eg on the website).
- Work to strict word limits (or reading-time limits).
- Simplify the language used.
- Present material in a way that assists users to absorb it.
- Aim for consistency between reports.

Judgement

- Focus on the key issues or material matters.
- Capture the essence of the issue, not the full depth and breadth of every aspect of the issue.
- Choose the KPIs to be discussed.
- Report KPIs consistently to promote rigour in the reporting.
- Link items to the company's strategy and value-creation process.
- Align discussion with the company's strategic plan.
- Try to meet user needs, avoiding a 'tick box' approach.

Table 3.5 provides a number of quotes that illustrate preparers' views about achieving conciseness in reporting.

14 The authors have endeavoured to link these comments to the relevant headings, but recognise that the allocations reflect judgement and that others may classify the comments differently.

Table 3.5: Preparers' views – Factors affecting materiality conciseness

Factors affecting disclosure, including conciseness	Comments from interviews
Completeness, conciseness and comparability	'Another way we are trying to do this is by making sure that we actually show numbers where numbers are available, for example KPIs. We consistently report about them and this puts a level of rigour in our reporting and ensures that we don't just go and talk about our latest CSR efforts for example, but rather stick to the same things that we have every year' (CF2). 'In our case we've got three specific areas: impact, confidence and integrity and we have targets and initiatives in each of these areas so that forms a good starting point for how we focus on what we are doing. We are trying very hard to report and focus on what's most important in our main annual report' (S4). 'Another way of achieving conciseness is by using more info-grams… it's just a smarter way of presenting the information and making it more relevant, because people don't want to spend a lot of time reading annual reports, so by presenting it in the right way, you can have a lot of influence on how the information is absorbed or taken in' (IR6). 'Our business is complex – large and diverse. Beyond financial materiality, we have to consider stakeholders in various regions to ensure that there is a fairly balanced level of disclosure across all of our assets, even though at certain points, some are contributing more than others (ie not just financial materiality)' (IR1). 'We focus on what really matters and what's the essence of this risk. We try to draft with reference to that essence, but not trying to be complete in all potential aspects and certain areas around that topic, because as soon as you try to be complete, you do totally destroy conciseness and simplicity' (CF1). 'We are leaders in <IR>. We provide a lot of leadership, but that doesn't mean that on all areas we are willing to report in the most transparent way, because there are the sensitivities around strategy' (CF2).
Materiality determination process	Once we obtain the stakeholder engagement results, we prioritise them based on a 2x2 matrix. We try to identify the most important aspects to be reported on, then the second most important, and what comes thereafter. Conciseness is obtained based on reporting what is the most meaningful and what is the most prioritised' (CF4). 'We do not determine material matters based on a framework such as GRI. Material matters are those material to our long-term strategy' (CF2). 'We have a legal [sic] definition of materiality in accounting and that affects our application of the concept in <IR>. The goal of consistency means that the concept of materiality in those other documents (with a different purpose and for a legal interpretation) then flows into the integrated report, which is unhelpful in making <IR> useful' (CF1). 'We ask whether this information would influence our institutional investors' buy or sell decisions' (IR3). 'We ask those who are very supportive of our stock about what they see as positives and those who are negative about the stock, what they see as a negative. These inputs help filter, from an investors' standpoint, what really matters' (CF1). 'We try to show how the material aspects in our report are connected to our strategy. We know this is hard for some companies. We also try to connect strategy with risks we have identified in our risk management' (IR6).
Cross-referencing	'The print version is pretty standard because of the financial standards that we have to follow. In the online version, there is probably more potential for us to provide different levels of information and to make it easier for someone who wants to browse the information quickly' (IR5). 'We try to focus on what's important in our main annual report. However, [we give] far more detail on some issues, eg water usage, we provide supplementary disclosures on our website' (S4). 'The conciseness we are looking for in <IR> is providing an avenue that gets people to the information and makes it as accessible as possible' (IR2). 'If you look at our online reporting tool, you will be able to click into various sections of the annual review and then that will drill you down further into the certain aspects. So you can drill down to the sustainability case studies, details on a financial report, but you are starting at a high level within the annual review' (CF3).
Language/number of words	'We are trying to position the integrated report so that you don't have to have technical expertise to understand what we are saying, so we draft it in a way that is understandable to the average investor. That drives you towards conciseness and simplicity and trying to capture the essence of the issue, not the full breadth and depth of what that issue could be about' (CF1).
Generic disclosure	'Conciseness is an incredible challenge because of all the guidelines and standards we must follow. This year we tried to shorten the report to make it more concise, to simplify language and to remove all duplication; to say things more concisely, to really look and ask ourselves the question: 'do we really need that?' (IR5). 'What are the priority cases that we really want to report in that voluntary area and how do we better utilise the compliance sections, so that people aren't just saying, "they have ticked the boxes on these, but what do they actually mean?" Instead of just ticking a box, in terms of statutory reporting, we are actually telling people what bits they need to understand' (IR2).

The need to meet regulatory requirements dictates certain aspects of corporate reporting.

3.3.4 Challenges in <IR>

Two questions asked interviewees to comment on regulatory requirements and <IR> and to describe the challenges they had experienced in preparing an integrated report or becoming involved in <IR> (Interview questions 7 and 8, Appendix A1). The matters that were raised within the themes and subthemes (Appendix A2) are listed below under the headings of reporting requirements (how the various reporting requirements interact with the guidance for <IR>), extent of guidance (how the frameworks influence <IR>) and usefulness (the ways in which integrated reports are useful). Further comments from interviewees are provided in Table 3.6.

Reporting requirements

The need to meet regulatory requirements dictates certain aspects of corporate reporting. If these requirements also affect <IR>, eg through materiality concepts used in financial reporting, the usefulness of <IR> will suffer.

- For some entities, a concise report will not meet regulatory requirements or adequately describe the complexity of the business.
- Multiple reporting requirements (within a country and between countries) mean that several reports must be produced.
- Creating disclosure precedents through providing new (or forward-looking) information in the integrated report then can lead to legal obligations relating to disclosure.
- There is a need to be innovative and relevant in the integrated report and use other reports to meet statutory compliance obligations.

Extent of guidance

- The International <IR> Framework is very general in relation to materiality.
- Preparers are drawing on multiple frameworks and using parts they find helpful.
- Some information is sensitive and companies are reluctant to disclose.
- The measurement of some items is difficult or subjective thus the items are not reported.
- Creativity and 'out of the box' thinking are required.

Usefulness

- Determining and balancing stakeholder expectations is a challenge.
- Recognising the need to report at the 'right level': to produce a report that is not too broad. There is a risk that by trying to satisfy everyone, the report will satisfy no one.
- Balancing the 'good' and 'bad' news in a report that is useful and readable but does not become just a series of high-level statements.
- Including financial analysis in the report and explaining how financial performance affects other aspects of performance. Showing the links between graphics and text related to financial and non-financial indicators.
- Making the time to determine and undertake a new approach to reporting, not just building on what has been done previously.
- Ensuring support throughout the organisation for <IR>; promoting cultural change through <IR>; gaining support for <IR> from key personnel and divisions.
- Allowing integrated thinking and <IR> to develop together in the company and between divisions of the company.
- Learning how to use the new language such as business models and capitals.

Table 3.6: Preparers' views: Challenges for <IR>

Challenges for <IR>	Comments from interviews
What is the optimum amount of guidance?	'We try to be concise, but still useable and readable, because there is the risk of just a series of quite a high level of statements that are not particularly useful, so we trying to get that right balance' (CF1). 'One of the biggest challenges in integrated reporting is that the <IR> Framework…is more a contextual document. It doesn't have any guidelines and it is not precise in what it requires, unlike the GRI Framework' (CF4).
Where does <IR> fit with other reporting requirements and frameworks?	'The integrated report is not a filing document, so we have a little bit more flexibility in terms of what we include in the report. We do obviously make sure that it is consistent with the messaging in our regulatory filing documents…our disclosure committee plays a big role…they oversee the whole reporting process so they make sure that they review our 20-F for the US filing, the Annual Accounts and the Integrated Report' (S2).
What is the legal liability arising from forward-looking information?	'Because of the disclosure requirements we have from the various exchanges we're involved with, it is quite challenging for us to provide more forward-looking information than what we're prepared to…if we really go for the full principle of <IR> and provide a lot of that disclosure, it would then set a requirement for us to continue to keep the market informed of how we were going against all of those components of forward-looking statements' (IR1). 'It is really important that directors feel they are protected from the consequences of making honest statements. We put statements out there with all due process and best endeavours; if directors felt they had protection around those statements, I think they would feel far more comfortable pushing <IR> into being more useful and more forward-looking' (CF1).
How to determine user information needs	'The sustainability investors realise the value of reporting non-financials, but when I talk to mainstream investors, they don't always see the value in it. But by reporting non-financials, you simply increase transparency and therefore decrease risk. With risk aversion, I think you can win any investor over' (IR5).
How to collect and validate useful information (ensure the credibility of information)	'We aim to report against the important commitments of our organisation. We evaluate if we have robust data for the particular target so we can report against the target. Data collection processes for some targets are still evolving' (IR4). 'We use filters for materiality: First, we rate issues or KPIs across 11 dimensions and calculate a score. If the score is above a certain level, the item is viewed as material. Next, we review the data quality assurance process to ensure the quality of the underlying data that goes in our integrated report. Finally, we apply professional judgement' (S5).
User needs change over time	'We have a separate process where we go out to each of our stakeholders each year…this helps in terms of confirming that our balanced scorecard focuses on the right things and whether or not to adjust it and include more items or take some out' (CF2).
Businesses change over time	'We think it is important for the long term to have clear targets on natural energy sources. We apply a weighting and it is always subjective and can change over time. It is important to see how our reporting changes as well, as things become more or less important; that is part of our disclosure…to put it in the context of changes in expectations or changes in impact about material items' (IR5). 'Our matrix is changing year by year. So we have to keep doing this assessment to make it more specific and also I think it just changes as society changes and the economy changes' (S3).
Integrated thinking	'Along with <IR> comes the process of integrated thinking…the challenge has been to make the connections between the financial and the non-financial aspects of the business…to get people talking in ways that reflect the financial and non-financial aspects' (S2). 'On the internal side, the idea is that you want to have people integrated, rather than just ending up with an integrated report. That is a huge roadblock and in the earlier years of course, people didn't really see the relevance and only now are they starting to really buy into this idea. Some of the concepts and the framework are not the same language as we would speak here, for example, the concept of capital is not something we would usually think about and therefore we would call it something else, but it's a sensible concept as long as you figure out what it is about' (CF2).

> The interviewees identified a number of challenges for <IR>. Some of them were concerned about how <IR> fits within the other frameworks for corporate reporting, particularly statutory reporting.

3.4 CONCLUSION

The aim of the series of interviews was to provide insights about two issues.

- How do integrated report preparers determine which disclosures are material for report users?
- How do preparers achieve conciseness in their reports?

Representatives from 15 companies (from 10 countries and 6 industry sectors) that have been involved in <IR> gave their views.

These companies had well-developed processes for determining material matters and deciding what should be disclosed. There were many similarities in their processes, for example, seeking input from a wide range of stakeholders and using a number of parties within the company to evaluate this feedback and prioritise issues.

Interviewees presented several ways of achieving conciseness in reports. Although they are tailored to specific organisations, their examples may also be useful for other companies when they begin developing integrated reports.

The interviewees identified a number of challenges for <IR>. Some of them were concerned about how <IR> fits within the other frameworks for corporate reporting, particularly statutory reporting. Others commented that the demand for <IR> was not present in all user groups, and that balancing user needs was a challenge. Some suggested that initially getting commitment for <IR> within an organisation could be difficult. Others referred to the benefits of <IR>, in particular the way that embarking on <IR> was related to making the company itself more integrated, which in turn led to operational benefits.

4. Determining materiality – disclosure in integrated reports

The International <IR> Framework includes guiding principles for determining whether relevant items are material.

4.1 INTRODUCTION

The International <IR> Framework includes guiding principles for determining whether relevant items are material (see Table 3.2 in Chapter 3). The publicly available corporate reports of selected companies were reviewed to discover the extent to which those companies explained the materiality determination process in their reports and disclosed material items. This chapter reports on the findings of that review. Chapter 4 supplements the material presented in Chapter 3 by providing data about companies' practices, and points to illustrative examples of best practice. The research question addressed in this section is:

Question 3

To what extent do companies' corporate reports disclose their materiality determination process?

The corporate reports reviewed in this study were from 2012/13 so they predate the release of the International <IR> Framework in December 2013. Guidance for report preparers was available from the IIRC's earlier publications, including a discussion paper (IIRC 2011) and the International <IR> Framework Consultation Draft (IIRC 2013a).

4.2 DISCLOSURE IN INTEGRATED REPORTS

Corporate reports were collected from the list of companies included in the IIRC's <IR> Examples Database and <IR> Business Network and Johannesburg Stock Exchange (JSE) listed companies in the FTSE/JSE All-Share Index, where <IR> is required on a 'comply or explain' basis.[15] The FTSE/JSE index has 167 constituents, representing 99% of the market capitalisation of the South African stock market. The reports for 137 of these listed companies were

15 All companies listed on the Johannesburg Stock Exchange are required to comply with the corporate governance code King III. Consequently, for financial years commencing on or after 1 March 2010, they have to issue an integrated report or explain why they have not done so (van Zyl 2013).

There are many African companies in the sample. Therefore, the sample is partitioned by region because the practices of <IR> may differ in mandatory and non-mandatory settings and may be influenced by any prior national guidance.

collected. From the IIRC's <IR> Examples Database and <IR> Business Network, 141 companies were identified and the reports for 115 of these companies were accessed.[16] In total, reports were reviewed of a sample of 252 companies from countries throughout the world and identified 195 that stated they produced an integrated report or identified themselves as following principles of integrated reporting in 2012/13.

Companies were sorted per country on the basis of their headquarters. The South African sample (n=143) comprised 137 companies in the FTSE/JSE All-Share Index and three South African parastatals[17] and a further three JSE-listed companies that were not included in the FTSE/JSE All-Share Index. The latter six were included in the IIRC's <IR> Examples or were members of the <IR> Business Network.

Sample companies are from 28 countries with 57% from Africa (n=144), 25% from Europe (n=63), 9% from North and South America (n=23), 8% from Asia Oceania (n=20) and 1% from the Middle East (n=2) (Table 4.1). There are many African companies in the sample. Therefore, the sample is partitioned by region because the practices of <IR> may differ in mandatory and non-mandatory settings and may be influenced by any prior national guidance.[18] For example, for South African companies the King Code of Governance Principles (King III) contained guidance about integrated reporting although it did not make specific reference to materiality (Institute of Directors in Southern Africa 2009). The companies are also partitioned by industry sector to allow examination of any industry effects.

4.3 METHOD

Table 4.2 presents the numbers of companies in the sample that stated that they either prepared an integrated report or followed some of the principles of <IR>. Of the 252 companies, 147 (58%) stated on the cover of their report that it was an integrated report. A further 48 (19%) provided an annual report and indicated within the report that they followed at least some of the principles of <IR>. Of the 252 companies, only 195 companies were included in the review of the materiality determination process undertaken by companies.

In the full sample (n=252), 75% of companies in the Telecommunications sector prepared an integrated report, followed by 65% of companies in the Consumer cyclicals sector.[19] Companies in the Energy and Utilities sectors were the least likely to prepare an integrated report.

Table 4.1: Number of reports by country and region

Country	Number	%
Australia	6	2.38
Belgium	1	0.40
Brazil	9	3.57
Canada	4	1.59
Chile	1	0.40
China	1	0.40
Denmark	1	0.40
France	3	1.19
Germany	5	1.98
India	2	0.79
Italy	6	2.38
Japan	4	1.59
Luxembourg	2	0.79
Namibia	1	0.40

Country	Number	%
Netherlands	11	4.37
New Zealand	1	0.40
Pakistan	1	0.40
Russian Federation	1	0.40
Singapore	1	0.40
South Africa	143	56.75
South Korea	1	0.40
Spain	7	2.78
Sri Lanka	2	0.79
Sweden	1	0.40
Switzerland	2	0.79
Turkey	2	0.79
United Kingdom	24	9.52
USA	9	3.57
Overall	**252**	**100.00**

Region	Number	%
Africa	144	57.14
Americas	23	9.13
Asia Oceania	20	7.94
Europe	63	25.00
Middle East	2	0.79
Overall	**252**	**100.00**

16 When identifying companies in the IIRC databases, South African companies in the FTSE/JSE All-Share Index were excluded as they had already been included in the sample.

17 Parastatal entities are owned or controlled wholly or partly by the government.

18 African companies include 143 from South Africa and one from Namibia. Given the predominance of South African companies in the sample, companies from Africa are referred to as following a mandatory <IR> regime.

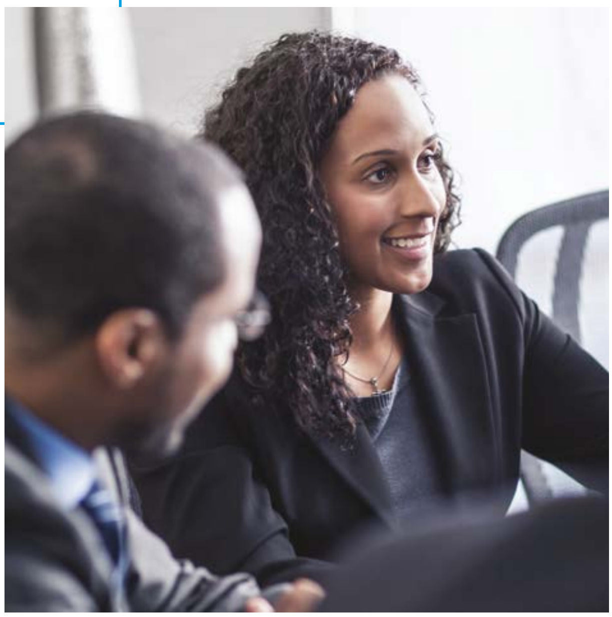
19 The consumer cyclicals sector consists of companies engaged in homebuilding, household goods, textiles and apparel, casino, leisure, media and retail operations (department stores, discount stores, apparel and computers) and services. The consumer non-cyclical sector consists of companies engaged in fishing and farming operations, food processing, beverages and tobacco, manufacturers of household and personal products, and providers of personal services, food distribution and retail drugs.

Table 4.2: Proportion of sample companies by industry sector that (i) called their report an integrated report or (ii) followed some principles of integrated reporting

		Number of sample companies stating they prepared an integrated report		Number of sample companies following some principles of integrated reporting			
Panel A: All companies	**N**	**N (A)**	**%**	**N (B)**	**%**	**(A) + (B)**	**%**
Basic materials	38	21	55	7	18	28	74
Consumer cyclicals	26	17	65	3	12	20	77
Consumer non-cyclicals	28	18	64	4	14	22	79
Energy	7	1	14	4	57	5	71
Financials	82	48	59	15	18	63	77
Healthcare	10	4	40	2	20	6	60
Industrials	37	24	65	7	19	31	84
Technology	9	5	56	2	22	7	78
Telecommunications	8	6	75	2	25	8	100
Utilities	7	3	43	2	29	5	71
Overall	**252**	**147**	**58**	**48**	**19**	**195**	**77**
Panel B: All companies excluding those from Africa							
Basic materials	16	1	6	6	38	7	44
Consumer cyclicals	7	0	0	3	43	3	43
Consumer non-cyclicals	9	2	22	4	44	6	67
Energy	6	0	0	4	67	4	67
Financials	36	6	17	13	36	19	53
Healthcare	5	0	0	2	40	2	40
Industrials	16	4	25	7	44	11	69
Technology	4	1	25	1	25	2	50
Telecommunications	3	1	33	2	67	3	100
Utilities	6	2	33	2	33	4	67
Overall	**108**	**17**	**16**	**44**	**41**	**61**	**56**
Panel C: African companies							
Basic materials	22	20	91	1	5	21	95
Consumer cyclicals	19	17	89	0	0	17	89
Consumer non-cyclicals	19	16	84	0	0	16	84
Energy	1	1	100	0	0	1	100
Financials	46	42	91	2	4	44	96
Healthcare	5	4	80	0	0	4	80
Industrials	21	20	95	0	0	20	95
Technology	5	4	80	1	20	5	100
Telecommunications	5	5	100	0	0	5	100
Utilities	1	1	100	0	0	1	100
Overall	**144**	**130**	**90**	**4**	**3**	**134**	**93**

Analysing the content of the reports showed that 123 companies that issued what they called an integrated report included a description of the steps they took to determine the materiality of items.

Table 4.2 Panel B shows the descriptive statistics for all companies, excluding those from Africa, and Panel C shows the statistics for the African companies. The variation in the adoption of <IR> across the industry sectors is predominantly caused by the non-African companies. Not surprisingly, a large proportion (n=130, 90%) of the African companies prepared integrated reports, and a small number of African companies (n=4, 3%) prepared



reports that followed some of the principles for integrated reporting. Of the 108 non-African companies, fewer than one-fifth (n=17, 16%) prepared integrated reports. Two-fifths (n=44, 41%) stated that their reports were in accordance with some principles of integrated reporting.

This sample of 195 companies (Table 4.2 Panel A) was used for the review of the materiality determination process undertaken by companies. The International <IR> Framework's description of the materiality determination process was selected to guide the assessment of companies' methods of determining materiality and explaining the process. As explained in Chapter 3, section 3.3.2 the International <IR> Framework identifies four steps in the process of determining materiality, being: (1) identifying relevant matters; (2) evaluating their importance; (3) prioritising important matters; and (4) determining information to disclose (IIRC 2013: 3.17–3.29). The extent to which the descriptions in the reports covered these four steps was recorded. The coding rules followed by the research assistants are provided in Appendix B. In the International <IR> Framework, step four refers to determining the information to disclose about material matters. For step four, whether companies disclosed material items was recorded. This was done because the discussion of disclosure decisions, if present, was combined with the information presented in steps one, two and three, and not presented separately in step four.

4.4 RESULTS

Analysing the content of the reports showed that 123 companies that issued what they called an integrated report included a description of the steps they took to determine the materiality of items (Table 4.3 Panel A). A further 13 companies stated in another form of corporate report (either an annual report or a sustainability report) that this process was undertaken. African companies were not more likely to provide such a description than companies from other countries (Table 4.3 Panels B and C).

Across the two sub-samples of companies (African vs non-African), 63% of the African companies provided a description of the materiality determination process in the integrated report compared with 62% of companies from the other regions. Significantly more non-African companies (n=12, 20%) than African companies (n=1, 1%), however, provided a description of the materiality determination process in their other reports (ie the sustainability report or annual report). Across the industry sectors, companies in Utilities were more likely than others to provide information on the evaluation process (Table 4.3 Panel A).

The results do not suggest that the mandatory regime (ie in South Africa) is more strongly associated with disclosure of the materiality determination process than the non-mandatory regimes. However, some of the companies reviewed have been selected as examples of best practice, so disclosures about materiality should be expected.

Table 4.3: Location of description of materiality determination process

	Total companies reviewed	Materiality determination process included in the integrated report	%	Materiality determination process included in another report	%	Materiality determination process not included	%
Panel A: All companies							
Basic materials	28	20	71	3	11	5	18
Consumer cyclicals	20	14	70	0	0	6	30
Consumer non-cyclicals	22	9	41	5	23	8	36
Energy	5	3	60	1	20	1	20
Financials	63	38	60	2	3	23	37
Healthcare	6	4	67	0	0	2	33
Industrials	31	22	71	0	0	9	29
Technology	7	3	43	0	0	4	57
Telecommunications	5	3	60	2	40	0	0
Utilities	8	7	88	0	0	1	12
Overall	**195**	**123**	**63**	**13**	**7**	**59**	**30**
Panel B: All companies excluding those from Africa							
Basic materials	7	4	57	2	29	1	14
Consumer cyclicals	3	3	100	0	0	0	0
Consumer non-cyclicals	6	1	17	5	83	0	0
Energy	4	2	50	1	25	1	25
Financials	19	12	63	2	11	5	26
Healthcare	2	2	100	0	0	0	0
Industrials	11	7	64	0	0	4	36
Technology	2	2	100	0	0	0	0
Telecommunications	4	2	50	2	50	0	0
Utilities	3	3	100	0	0	0	0
Overall	**61**	**38**	**62**	**12**	**20**	**11**	**18**
Panel C: African companies							
Basic materials	21	16	76	1	5	4	19
Consumer cyclicals	17	11	65	0	0	6	35
Consumer non-cyclicals	16	8	50	0	0	8	50
Energy	1	1	100	0	0	0	0
Financials	44	26	59	0	0	18	41
Healthcare	4	2	50	0	0	2	50
Industrials	20	15	75	0	0	5	25
Technology	5	1	20	0	0	4	80
Telecommunications	1	1	100	0	0	0	0
Utilities	5	4	80	0	0	1	20
Overall	**134**	**85**	**63**	**1**	**1**	**48**	**36**

Table 4.4: Content of description of materiality-determination process

	Companies with disclosure of a materiality-determination process	(1) Identify	(2) Evaluate	(3) Prioritise	(4) Disclose
Panel A: All companies with disclosure of a materiality-determination process					
Basic materials	23	20	9	3	19
Consumer cyclicals	14	14	4	4	11
Consumer non-cyclicals	14	7	0	2	11
Energy	4	4	1	0	2
Financials	40	37	6	8	24
Healthcare	4	4	0	0	3
Industrials	22	21	4	3	20
Technology	3	3	1	0	3
Telecommunications	5	5	4	3	4
Utilities	7	6	2	3	5
Overall **%**	**136** **100**	**121** **89**	**31** **23**	**26** **19**	**102** **75**
Panel B: All non-African companies					
Basic materials	6	4	2	2	5
Consumer cyclicals	3	3	2	3	3
Consumer non-cyclicals	6	4	0	1	4
Energy	3	3	1	0	1
Financials	14	13	4	6	8
Healthcare	2	2	0	0	1
Industrials	7	7	2	1	6
Technology	2	2	1	0	2
Telecommunications	4	4	3	3	3
Utilities	3	2	2	2	2
Overall **%**	**50** **100**	**44** **88**	**17** **34**	**18** **36**	**35** **70**
Panel C: African companies					
Basic materials	17	16	7	1	14
Consumer cyclicals	11	11	2	1	8
Consumer non-cyclicals	8	3	0	1	7
Energy	1	1	0	0	1
Financials	26	24	2	2	16
Healthcare	2	2	0	0	2
Industrials	15	14	2	2	14
Technology	1	1	0	0	1
Telecommunications	1	1	1	0	1
Utilities	4	4	0	1	3
Overall **%**	**86** **100**	**77** **90**	**14** **16**	**8** **9**	**67** **78**

Table 4.5: Presentation methods for disclosure of a materiality determination process

	Companies with disclosure	Lists	Figures	Tables	Text
Panel A: All companies with disclosure of a materiality-determination process					
Basic materials	23	5	8	12	19
Consumer cyclicals	14	3	5	9	13
Consumer non-cyclicals	14	2	2	7	9
Energy	4	2	1	2	3
Financials	40	7	9	14	34
Healthcare	4	0	1	2	4
Industrials	22	4	6	14	20
Technology	3	0	1	1	3
Telecommunications	5	1	3	1	5
Utilities	7	0	3	1	7
Overall **%**	**136** **100**	**24** **18**	**39** **29**	**63** **46**	**117** **86**
Panel B: All non-African companies					
Basic materials	6	1	3	2	6
Consumer cyclicals	3	2	2	2	3
Consumer non-cyclicals	6	1	1	1	6
Energy	3	2	1	1	2
Financials	14	2	4	6	10
Healthcare	2	0	1	1	2
Industrials	7	2	4	4	6
Technology	2	0	1	0	2
Telecommunications	4	0	3	0	4
Utilities	3	0	2	0	3
Overall **%**	**50** **100**	**10** **20**	**22** **44**	**17** **34**	**44** **88**
Panel C: African companies					
Basic materials	17	4	5	10	13
Consumer cyclicals	11	1	3	7	10
Consumer non-cyclicals	8	1	1	6	3
Energy	1	0	0	1	1
Financials	26	5	5	8	24
Healthcare	2	0	0	1	2
Industrials	15	2	2	10	14
Technology	1	0	0	1	1
Telecommunications	1	1	0	1	1
Utilities	4	0	1	1	4
Overall **%**	**86** **100**	**14** **16**	**17** **20**	**46** **53**	**73** **85**

In partitioning the sample by industry sector, the study does not show that disclosure of the process is clearly different across the various sectors.

Considering the materiality determination process, as described in the International <IR> Framework, for 136 companies, Table 4.4 (Panel A) shows that the majority of companies (n=121, 89%) explained how they identified relevant matters as material (step 1) and many subsequently provided information about the items they identified as material (n=102, 75%) (step 4). Information on the evaluation process used and the prioritising of material items (steps 2 and 3) was provided by fewer than a quarter of companies (n=31, 23% and n=26, 19% respectively). The African companies were marginally less likely to provide information on steps (2) and (3) and were more likely to provide information on steps (1) and (4) (Table 4.4 Panels B and C). In partitioning the sample by industry sector, the study does not show that disclosure of the process is clearly different across the various sectors.

Information was collected about the presentation style (lists, figures, tables and text) for disclosure about the materiality determination process and material items in the sample companies' reports (Table 4.5). For data collection purposes, we defined the four categories as follows:

List: A number of items presented consecutively, for example, material issues are listed via bullet points.

Graph: A diagram showing the relationship of at least two variables, using an horizontal axis and vertical axis at right angles.

Table: Data is presented in rows and columns, including comparative columns.

Figure: An illustrative drawing (or diagram) using a combination of shapes, text and colours.

Of the 136 companies that provided disclosure, 117 used narrative text, 63 used tables, 39 used figures and 24 used lists. The African companies were more likely to use tables and less likely to use figures than the non-African companies.

Further analysis revealed that 37 out of the 136 companies used text as the sole form of presentation. A total of 57 companies used a combination of text and tables (32), text and figures (17) and lists and text (8). Materiality explanations are often based on lists, figures and tables. This is consistent with comments from interviewees in Chapter 3, section 3.3.3 explaining the various ways in which companies achieve conciseness in reports.

Table 4.6: Text presentation methods for the materiality-determination process

Method	N	Method	N
Text only	38	Text and Tables	32
Tables only	9	Figures and Text	17
Figures only	3	Lists and Text	8
Lists only	1	Figures and Tables	2
		Lists and Tables	1
		Lists and Figures	1
Figures, Tables and Text	10	List, Figures, Tables and Text	2
Lists, Tables and Text	6		
Lists, Figures and Text	2		

Companies vary in the extent to which they use text, tables, figures and graphs to explain their materiality determination process.

4.5 COMPANY EXAMPLES

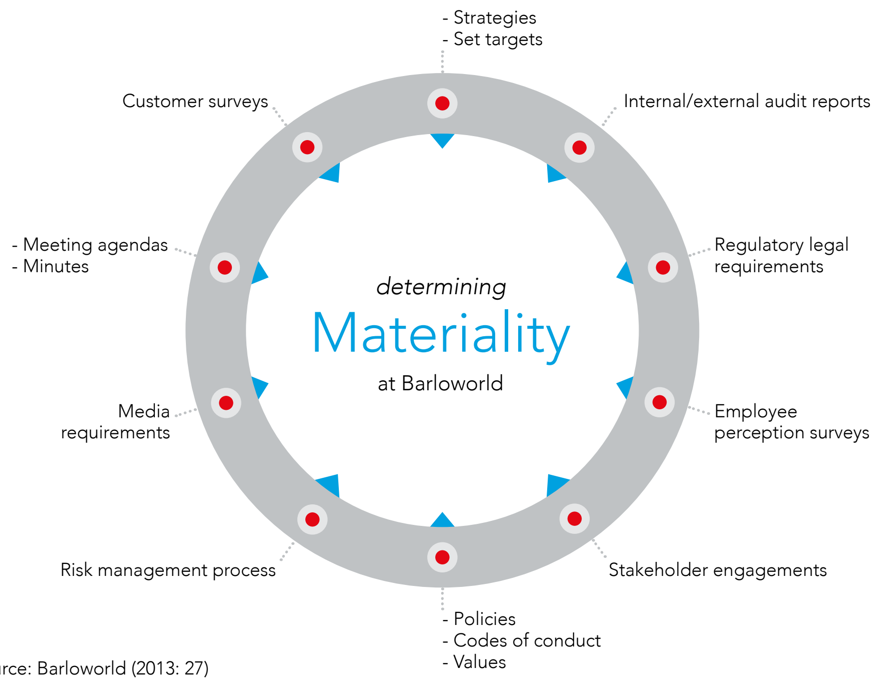
The review of the corporate reports revealed the following information about their descriptions of the process for determining materiality.

4.5.1 Describing the materiality-determination process

Companies vary in the extent to which they use text, tables, figures and graphs to explain their materiality determination process. For example, Barloworld provides a description of the factors that affect the 'identification, prioritization and ratification of issues deemed material to Barloworld's value creation activities' (Barloworld 2013: 27). In addition, the company provides a figure to represent the various relevant factors (Figure 4.1).

Stockland (2013) provides a table that succinctly summarises the materiality process, referring to four steps and the company's activities in each. The company promotes conciseness by using hyperlinks to supporting material (Integrated Report materiality process in Figure 4.2).

Figure 4.1: The determination of materiality at Barloworld



Source: Barloworld (2013: 27)

Figure 4.2: The determination of materiality at Stockland

Identify ➔	**Prioritise ➔**	**Align ➔**	**Disclose**
Research and engagement	*Workshop and strategy*	*Alignment and disclosure*	
Desktop Research amd extensive Stakeholder Engagement was undertaken to ascertain relevant issues and concerns as identified by: - Our Peers - Our Stakeholders - Company reports - Political and Regulatory Developments - Social and Mainstream Media The resultant list of issues served as a prompt and guidance for our Materiality Workshop.	A Materiality Workshop was held with members of the Sustainable Communities Team to identify any additional relevant issues, rank those issues of greatest significance, and prioritize them based on their ability to create business and social value over time. The team then identified which targeted focus areas would enable the company to effectively and strategically address these material issues.	Following the Materiality Workshop, the material issues and sustainability focus areas were aligned with the material matters identified in the Integrated Report materiality process. We aligned with GRI G4 guidelines to ensure structure and content of the online report prioritised disclosure of material sustainability issues, and effectively and objectively illustrated our sustainable performance.	

Source: Stockland (2013: 2)

Several companies refer to using the GRI G4 materiality assessment process to guide the evaluation and prioritisation phases, although the GRI Framework relates to sustainability reports not integrated reports.

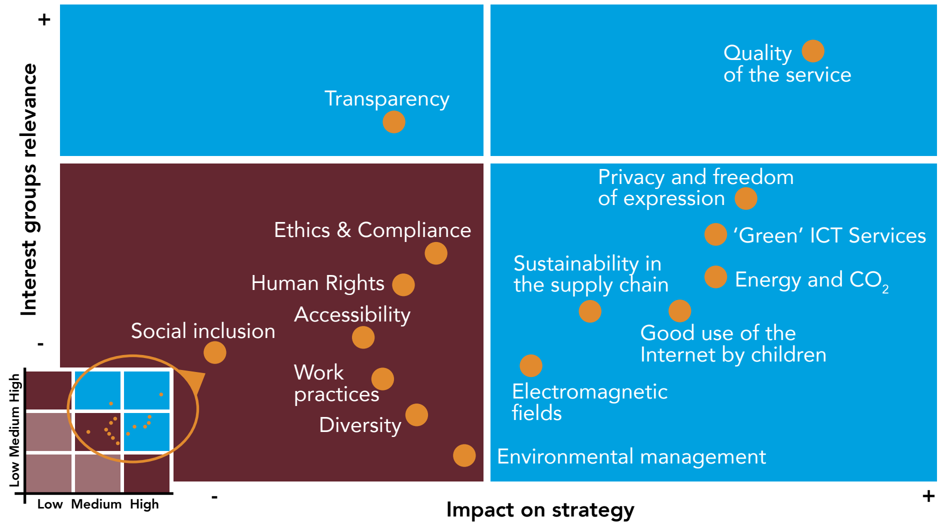
4.5.2 Use of materiality guidelines from GRI

Several companies refer to using the GRI G4 materiality assessment process to guide the evaluation and prioritisation phases, although the GRI Framework relates to sustainability reports not integrated reports. Some include or describe a GRI G4-type materiality matrix chart in their report (eg Aegon 2013; Atlantia 2013; BAM 2013; City Lodge Hotel Group 2013; EnBW 2013; Enel 2013; Inditex 2013; SK Telecom 2013; Snam 2013; Telefonica 2013 (see Figure 4.3)).

The GRI G4 matrix chart recommends a horizontal axis showing the significance of impact of economic, environmental and social effects and a vertical axis reflecting the influence on stakeholder assessments and decisions. The horizontal axis shows the organisation's significant economic, environmental and social impacts. The vertical axis shows how influential a sustainability issue is for stakeholders. 'Stakeholders' in this context are for the most part external stakeholders, although internal stakeholders may also be included.

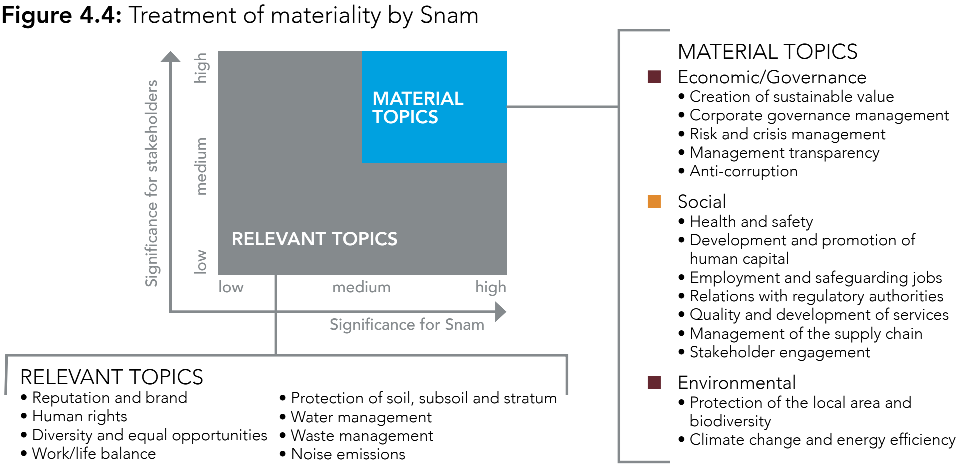
The top right quadrant of a GRI G4 materiality matrix chart contains topics that are both have significant economic, environmental and social impacts and substantively influence the assessments and decisions of stakeholders. These issues are given the highest reporting priority. This approach is effectively presented in the materiality matrix of Snam (Figure 4.4). It should be noted that in this example, the significance of economic, environmental and social impacts have been interpreted through the lens of their potential effect on the company.

Figure 4.3: Telefonica's materiality matrix



Source: Telefonica (2013: 87)

Figure 4.4: Treatment of materiality by Snam



Source: Snam (2013: 16)

The corporate reports reviewed suggest that the input for the stakeholder assessment scores is channelled through many different devices.

A standard GRI G4 materiality matrix assumes that all bubbles (representing relevant issues) are the same size. The GRI G4 materiality matrix can be further developed, for example, by using a materiality tool that adds functionality and allows companies to adjust the bubble size according to, for example, the number of stakeholders who gave feedback on that

issue (see eg Sustainability Reporting Examiner n.d.). This adds insight on what issues are prominent among stakeholders.

4.5.3 Stakeholder input

The corporate reports reviewed suggest that the input for the stakeholder assessment scores is channelled through many different devices: formal feedback from stakeholders (eg non-government organisations, investor groups, union and supplier representatives) obtained through, for example, one-to-one interviews, multi-stakeholder workshops, online ranking devices, professional polling agencies, imitation/benchmarking of what peers report and from sector analyses, inclusion in 'rater and ranker' questionnaires, social and mainstream media reports, and existing or pending regulation.

The relative importance of the stakeholder feedback mechanisms for the first phase of the materiality identification process (the identification of relevant matters) and the second and third phases (evaluation and prioritising) is not always apparent from the reports. Prominence of matters in the external feedback may point to their importance in both identifying relevant issues and assessing their significance, but the reports may not make this distinction clear.

Atlantia (2013: 54) provides an interesting example of criteria that can be considered with respect to stakeholders in the materiality analysis: responsibility, influence, proximity, representation and strategy. For stakeholders, the analysis of each individual issue is based on two dimensions: first, the level of impact that the issue can have on stakeholder expectations towards Atlantia, and second, the level of interest about the issue measured by requests for information about performance, past actions, future plans and so forth.

The input for the assessment of the significance for the company's business is provided by internal stakeholders and may refer to impact on current performance, ability to exert influence over the topic, business risk and licence to operate, or potential risk to the company's supply chain. Risk-management processes seem to play a key role in such assessments.

4.5.4. Materiality is not just about financial materiality

Some companies (eg PepsiCo 2013) explicitly mention that the materiality focus of their report is broader than the traditional measures of financial materiality used for financial reporting purposes. They make clear that the materiality concept used in the report should not be confused with a threshold that is commonly used for influencing the economic decisions of users of financial statements. Thus, the materiality concept should relate to a wider range of issues and stakeholders and should also include a range of capitals that are expected to affect the company's ability to create value in the short, medium and long term.

Companies made use of a range of presentation styles (including lists, figures, tables and text) and techniques (format, structure, cross-referencing and linked documents) to provide the information in a concise and easily accessible manner.

4.5.5. Value creation

In some reports a 'Financial Materiality Adjustment' (SK Telecom 2013: 46) or a strategic 'Risk and Opportunity' filter (Sasol 2013: 96) is added to arrive at a prioritised set of reporting topics. Through such an adjustment, the effect of each material subject on the company's financial value on a mid- to long-term basis is assessed and weighed in terms of 'Risk', 'Market competition' and 'Future value creation' (SK Telecom 2013: 46). Such an additional layer is basically driven by the views of the company's board and management.

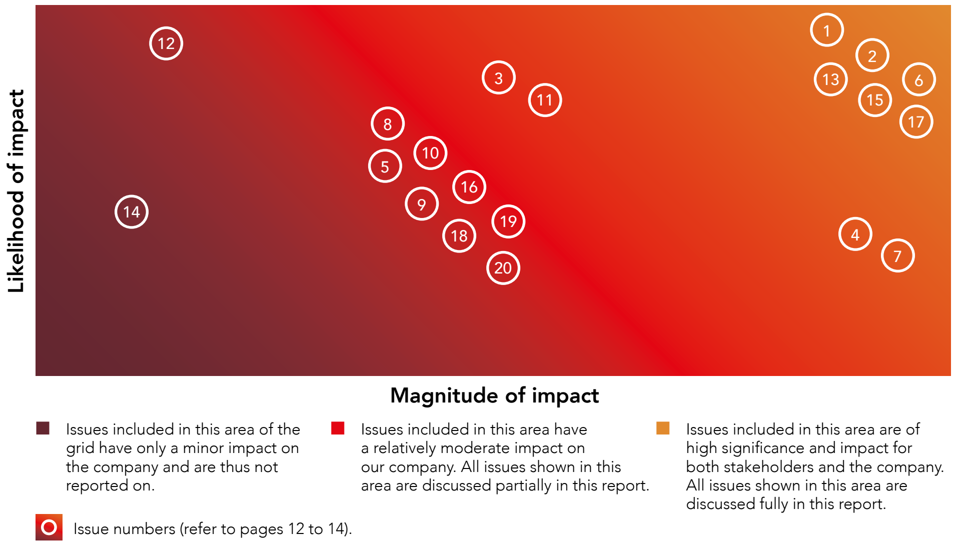
City Lodge Hotel Group (2013: 11) also presents an additional layer in a 'Material issues heatmap', in which material issues are presented on a graph according to the likelihood of impact (vertical axis) and magnitude of impact (horizontal axis), in order to determine whether to make full or partial disclosure or none at all (Figure 4.5).

4.6 CONCLUSION

The 252 integrated reports and other corporate reports reviewed were published by companies from 28 countries based in five regions of the world. Of these, 136 companies include a description of the process they used to determine materiality in their reports. These descriptions usually focus on how companies identify material items, and they provide a list of such items. Because relatively few companies provided disclosure about how they evaluated and prioritised matters identified as material, these issues might not necessarily be clear to external report users. Companies made use of a range of presentation styles (including lists, figures, tables and text) and techniques (format, structure, cross-referencing and linked documents) to provide the information in a concise and easily accessible manner.

The company disclosures reviewed provided many examples of current practice in disclosure, which may be expected from companies that chose to be in the IIRC's <IR> Business Network or were selected for the IIRC's <IR> Examples Database. South African companies were more likely to provide a report called an integrated report, which is consistent with the 'comply or explain' regime for integrated reporting in that country. Nonetheless, no significant differences were found between countries or industry sectors in the description of the materiality determination process or the methods used to present the information.

Figure 4.5: City Lodge Hotel Group material issues heatmap



Source: City Lodge Hotel Group (2013: 11)

5. Factors affecting materiality judgements – insights from preparers and auditors

The third stage of the project involved a behavioural experiment with corporate report preparers and companies' external auditors.

5.1 INTRODUCTION

The third stage of the project involved a behavioural experiment with corporate report preparers and companies' external auditors. The experiment investigated the extent to which participants viewed items of information as material and whether their materiality judgements were affected by the magnitude and likelihood of occurrence of the items and the type of item (eg relating to financial, environmental and social matters).[20] The International <IR> Framework (IIRC 2013b) provides guidance for defining materiality and states that magnitude and likelihood of occurrence will affect a person's judgement about whether an item is material.[21] The Framework also describes six capitals that are used by organisations in value creation: financial, manufactured, intellectual, human, social and relationship, and natural (IIRC 2013b: 11–12). The categorisation of each item of information as financial, environmental or social touches on aspects of four of the capitals in <IR>, namely financial, human, social and relationship, and natural.

The aim of the experiment was to provide data to complement that gathered in the previous stages of the research. Importantly, the experiment allows for an exploration of materiality judgements in the context of three elements that relate to some of the six capitals; the six capitals being a fundamental part of the <IR> principles. A benefit of a behavioural experiment is that people's views can be inferred from their behaviour, that is, observation provides direct evidence (Libby et al. 2002). This contrasts with the evidence gathered in interviews, where the researcher is unable to determine the veracity of the views expressed. The evidence gathered is relevant to the fourth and fifth research questions stated in Chapter 1.

20 The experimental instrument is available on request from the authors.

21 Guidance from the International <IR> Framework (emphasis added) '3.24. 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.'

It was predicted that participants would generally view items with higher magnitude and higher likelihood as more material, and items with lower magnitude and lower likelihood as less material.

Question 4
How does the magnitude and likelihood of an item of information affect report preparers' and auditors' judgements about the materiality of the item?

Question 5
To what extent does the type of item of information (for example, financial, social or environmental) affect report preparers' and auditors' judgements about the materiality of the item?

The research expectations were as follows.

1. It was predicted that participants would generally view items with higher magnitude and higher likelihood as more material, and items with lower magnitude and lower likelihood as less material. This prediction is consistent with rational economic decision-making and is shown in Table 5.1.

2. There was uncertainty about the extent to which higher-magnitude/lower-likelihood and lower-magnitude/higher-likelihood items would be viewed as material. That is, how would magnitude and likelihood interact to affect views about materiality? If magnitude dominates likelihood in people's perceptions, the result shown in Table 5.1 may be observed where high-magnitude items (of both high and low likelihood) are more likely to be viewed as material.

3. It was predicted that participants would be more likely to view the financial items as more material and more strongly linked to value creation than the environmental and social items.[22] This prediction was based on the fact that, historically, financial reporting has focused more on financial than non-financial items as the main source of value creation for a company (see discussion in Eccles et al. 2011).[23] Edmans (2011) shows that non-financial items (ie intangibles), such as employee satisfaction, only affect share price when they are manifest in financial items (ie as tangible assets). Whether corporate social responsibility initiatives are necessarily value-creating is unclear (see Krueger 2015).

5.2 PARTICIPANTS

There were 96 participants in the experiment, which was conducted in October and November 2014 in Perth, Western Australia and in November 2014 in the UK. Participants included 31 auditors (eight from the UK) and 65 accountancy practitioners, of whom 30 were currently employed in the mining industry.[24] Of the 96 participants, 58 (60%) had tertiary education qualifications. Participants were generally experienced professionals with an average of seven years' work experience (minimum six months and maximum 28 years). Their work experience was as

Table 5.1: Predictions of impact of interaction of magnitude and likelihood

	Magnitude – high (HM)	Magnitude – low (LM)
Likelihood – high (HL)	HMHL Material	LMHL Not material
Likelihood – low (LL)	HMLL Material	LMLL Not material

22 Financial items are defined as monetary items included in a company's financial statements (Balance Sheet and Statement of Profit or Loss and Other Comprehensive Income as per IAS 1). The environmental and social items include some items without direct financial impact and other items that could not be measured in monetary units and do not have financial consequences for the company or others.

23 Eccles et al. (2011) discuss the development of frameworks for reporting non-financial information. Since 2008 a number of organisations have issued frameworks and guidance to assist companies in identifying non-financial information. The number and diversity of frameworks can, however, cause confusion as to which framework to apply.

24 The high proportion of participants employed in the mining sector reflected the client base of the accounting firm, BDO.

The participants were approached to take part in the experiment on the basis of their work experience in preparing or auditing companies' statutory financial statements and interim and annual reports.

follows: 61 had experience working as preparers, 65 had experience as auditors and 39 had experience as users of general-purpose financial statements (Table 5.2). Participants could indicate that they belonged to more than one group if they had experience in more than one of the three categories.

The participants were approached to take part in the experiment on the basis of their work experience in preparing or auditing companies' statutory financial statements and interim and annual reports. None were specifically involved in the preparation or audit of integrated reports, and they varied in their experience of determining the materiality of a range of financial and non-financial items.

Table 5.2 provides demographic information for participants. Work experience, industry affiliation and education are presented. In the work experience section, 'an auditor' is someone who has experience *only* as an external auditor of listed companies. An 'accountant/CFO/financial controller' is someone who may *also* have experience as an external auditor. In the 'years of experience' section, the number of years of professional work experience in the roles of preparer and auditor is shown.

5.3 INSTRUMENT

An experimental instrument was developed that presents a case scenario based on a draft of the 'Chairperson's letter' to shareholders (ie a non-audited, non-reviewed document in the annual report) for a fictitious mining company listed on the London Stock Exchange and operating in two countries.[25] In the letter the chairperson refers to events in 2013. The text includes a number of items

Table 5.2: Participants' demographic information

Work experience	***n***		
Auditor	31		
Accountant/CFO/Financial Controller	47		
Other management role	18		
	96		
Industry	***n***		
Accounting profession	39		
Mining	30		
Other	26		
Not stated	1		
	96		
Education and training	***n***		
Professional qualification	34		
Bachelor's degree	35		
Master's degree	11		
Postgraduate	12		
Not stated	4		
	96		
Years of experience with financial statements	**Professional work**	**Preparer**	**Auditor**
n	94	61	65
Mean	7.0	4.2	4.3
Min	0.5	0.5	0.3
Max	28.0	28.0	25.0
Stdev	6.7	4.4	4.0

n = number of responses

25 The instrument is available from the authors upon request.

> The participants' task was to review some additional items of information and indicate whether they should be included in the letter, on the basis of the materiality of each item.

relating to financial, social and environmental matters that could affect the company's ability to create value for providers of financial capital.

The participants' task was to review some additional items of information and indicate whether they should be included in the letter, on the basis of the materiality of each item.[26] Using a 0–100 Likert scale, participants were asked to indicate for each item: the level of materiality; their confidence in their assessment; their assessment of the likelihood and magnitude of the event; and the strength of the link between the item and value creation for the company, as the enabler of financial returns to the providers of financial capital. Larger scores indicated higher assessments for the item.

Magnitude was varied by using two scenarios. In scenario (a) a mine contributed 20% of company earnings before interest and tax (EBIT); in scenario (b) the mine contributed 80% of company EBIT. All participants received an instrument containing both scenarios and magnitude is a 'within subjects' manipulation (ie the same set of participants considered both the scenarios). Thus, the magnitude of the mine contribution is clearly material in both scenarios in the financial sense (ie the contribution of EBIT to group earnings is greater than 10%), but magnitude is greater in scenario (b) than in scenario (a). In closing questions, participants were also asked to indicate the magnitude of items in the case study using a 0–100 Likert scale. Thus participants' *perceptions* of magnitude were also recorded.

Likelihood was indicated for six items (two each of financial, environment and social items) through the description of the item. Each of the six items had a high likelihood version and low likelihood version (12 items in total). For each item, the type and likelihood was indicated by the words used. For example, as shown in Table 5.3, the first item relates to a financial matter, which the text indicates is highly likely to occur. In contrast, the text indicates low likelihood of occurrence for the second item. The third example is an environmental item with low likelihood and the fourth item is a social item with high likelihood of occurrence.[27] In addition, to compensate for individual variation in interpretation, one question in the case was used to ask participants about their opinion of likelihood.

The experimental instrument was developed collectively by all members of the research team and was pilot tested with auditors at BDO Perth and with academic colleagues. Various modifications were made after pilot testing to improve the effectiveness of the instrument.

Table 5.3: Examples of high- and low-likelihood items

Financial: High	Research into development of a motor vehicle powered by a fuel extracted from Nanu Rock has reached the patent registration stage and a prototype vehicle has been successfully tested.
Financial: Low	The government of Country A is considering introducing a resource revenue tax to increase its revenue. The new tax lacks the support of the mining industry and some political parties.
Environment: Low	Company receives the occasional complaint from members of the community about the noise of mining operations at ZiZi Point and trucks passing the town.
Social: High	A competitor company is expected to begin operating a large open-cut mine in the region in 2014 and to commence targeting the ZiZi Point mine staff as potential employees.

26 The participants were provided with the definition of materiality from the International <IR> Framework (2013b: 3.37).

27 Only qualitative descriptions of likelihood were included for two reasons. First, narrative reports provided by companies (for example, in operating and financial reviews and other sections in the annual report) often use qualitative descriptions without quantification. Thus, a qualitative description would arguably be generally more representative of actual reporting. Second, the use of numbers to quantify impact would be more likely to prompt assessments of materiality in numerical or financial terms. There was no intention of prompting more recognition of financial items as material and less recognition of environmental and social items as material by quantifying the items.

The results of the experiment provided support for the first research expectation that participants would generally view items with high magnitude and high likelihood as more material and items with low magnitude and low likelihood as less material.

5.4 RESULTS

5.4.1 Univariate tests

The results of the experiment provided support for the first research expectation that participants would generally view items with high magnitude and high likelihood as more material and items with low magnitude and low likelihood as less material.

Table 5.4 presents the average responses of participants to four questions on (1) whether they consider the item to be material; (2) their level of confidence in their decision; (3) their view about the likelihood of the event's occurrence; and (4) the extent to which they think the item is directly linked to value creation for the company. Panel A presents the responses to questions manipulated by magnitude and likelihood. Panel B presents the responses to questions on items classified by type.

Panel A in Table 5.4 shows that participants effectively distinguished between items on the basis of magnitude and likelihood. The high magnitude–high likelihood items have the highest scores for materiality and value creation (columns 1 and 4) while low magnitude–low likelihood items have the lowest scores. Participants are more confident about their judgement of materiality for high-high items and for low-low items than for the mixed high-low items.

In relation to the second research expectation, Table 5.4 Panel A shows that magnitude dominates likelihood in the interaction of the two concepts. An item with high magnitude and low likelihood is perceived as more likely to occur than an item that has low magnitude and low likelihood (column 3, likelihood scores of 66.19 vs. 53.81) even though both items have the same (low) likelihood. Similarly, an item with high magnitude and high likelihood is perceived as more likely than an item that has low magnitude and high likelihood (column 3, likelihood scores of 68.25 vs. 59.41) even though both items have the same (high) likelihood. Table 5.5 shows that this pattern holds for all groups of items (financial, environmental and social) when they are considered in separate groups, as can be seen in column 3 in Panels A, B and C.

Table 5.5 presents the average responses of participants to four questions on (1) whether they consider the item to be material; (2) their level of confidence in their decision; (3) their view about the likelihood of the event's occurrence; and (4) the extent to which they think the item is directly linked to value creation for the company. Panels A, B and C present the responses to questions on items that are of financial, environmental and social nature.

Table 5.4: Responses to the case study

Panel A: Manipulated by magnitude and likelihood	*n*	(1) Materiality	(2) Confidence	(3) Likelihood	(4) Value creation
High Magnitude/Low Likelihood	286	54.55	71.99	66.19	55.42
High Magnitude/High Likelihood	287	67.28	76.17	68.25	67.44
Low Magnitude/Low Likelihood	288	43.54	73.13	53.81	47.94
Low Magnitude/High Likelihood	289	55.22	71.49	59.41	57.96
F-test		33.39***	3.25**	24.10***	24.94***
Panel B: By items	***n***	**(1) Materiality**	**(2) Confidence**	**(3) Likelihood**	**(4) Value creation**
Environment	400	52.21	72.88	61.74	51.89
Financial	384	65.81	74.38	60.29	67.66
Social	366	47.14	72.30	63.80	52.04
F-test		43.06***	1.11	2.14	42.67***

*** significant at p > 0.01, ** significant at p > 0.05. *n* = number of responses

As expected in the third research prediction, participants viewed financial items as more material and more strongly linked to value creation than the environmental and social items.

First, the results for ranking of materiality of items (high–high first, low–low last and the other two in the middle) hold for all items, irrespective of type. This is also observed for value creation (column 4). Second, the scores for financial items are higher than for environment and social items. Column 1 shows that a low–low financial item scores 54.48 for materiality, and this is higher than all environmental and social items except the high–high item in each group (high magnitude–high likelihood environmental = 63.47; high magnitude–high likelihood social = 59.67). A similar pattern is observed for value creation (column 4).

As expected in the third research prediction, participants viewed financial items as more material and more strongly linked to value creation than the environmental and social items (Table 5.4, Panel B). These findings are interesting given the mixed evidence previously presented in the literature. For example, prior studies show that analysts do not use non-financial data such as consumer satisfaction when projecting the company's future performance (Aksoy et al. 2008; Keiningham et al. 2005). On the other hand, others such as Jiao (2010) find that stakeholder welfare captured in environmental performance is related to Tobin's Q.[28]

The results in Table 5.5 show that the environmental and social items are linked to value creation but less strongly than the financial items. Interestingly, the participants' level of confidence in their judgement of materiality did not differ by type of item (column 2, F = 1.11 not significant). Table 5.6 reports the items in groups that are based on magnitude and likelihood (high–high; high–low; low–high; and low–low).

Table 5.5: Responses to the case study by item type

Panel A: Questions on financial items	*n*	(1) Materiality	(2) Confidence	(3) Likelihood	(4) Value creation
High Magnitude/Low Likelihood	96	64.79	74.79	63.75	64.48
High Magnitude/High Likelihood	96	78.44	77.71	69.84	79.79
Low Magnitude/Low Likelihood	96	54.48	71.46	51.21	57.37
Low Magnitude/High Likelihood	96	65.52	73.54	56.25	68.91
F-test		14.11***	1.79	12.05***	15.07***
Panel B: Questions on environmental items	***n***	**(1) Materiality**	**(2) Confidence**	**(3) Likelihood**	**(4) Value creation**
High Magnitude/Low Likelihood	90	54.33	70.11	67.33	52.44
High Magnitude/High Likelihood	101	63.47	76.53	68.69	60.50
Low Magnitude/Low Likelihood	110	39.73	73.82	53.49	44.04
Low Magnitude/High Likelihood	99	52.68	70.61	58.79	51.26
F-test		12.10***	2.11*	9.62***	5.83***
Panel C: Questions on social items	***n***	**(1) Materiality**	**(2) Confidence**	**(3) Likelihood**	**(4) Value creation**
High Magnitude/Low Likelihood	100	44.90	71.00	67.50	49.40
High Magnitude/High Likelihood	90	59.67	74.11	66.06	62.06
Low Magnitude/Low Likelihood	82	35.85	74.15	57.28	42.20
Low Magnitude/High Likelihood	94	47.39	70.32	63.33	53.83
F-test		10.97***	0.97	3.91***	8.59***

*** significant at p > 0.01, * significant at p > 0.10. *n* = number of responses

28 Other studies examining the long-run stock performance of leaders in corporate responsibility reporting include Eccles and Serafeim (2013) and Borgers et al. (2013). Tobin's q is the ratio of the market value of the company's assets divided by the replacement cost of the company's assets.

The results suggest that financial items are usually considered more material and with higher value-creation potential than the environmental and social items.

Table 5.6 presents the average responses of participants to four questions on (1) whether they consider the item to be material; (2) their level of confidence in their decision; (3) their view about the likelihood of the event's occurrence; and (4) the extent to which they think the item is directly linked to value creation for the company. Panels A, B, C and D present the responses to questions on items that are of: high magnitude and high likelihood; high magnitude and low likelihood; low magnitude and high likelihood; and low magnitude and low likelihood respectively. The results suggest that financial items are usually considered more material and with higher value-creation potential than the environmental and social items. The results are supported by the evidence that participants do not differ in their confidence about their materiality judgements across the three item types in each of the four groups. In addition, the participants do not differ in their assessment of likelihood across the three item types within each of the four groups.

5.4.2 Multivariate tests

Ordinary least squares regression models were also used to test the relationship of materiality, magnitude and likelihood. The models, variables and definitions are shown in Table 5.7. The models explore the explanatory factors for the materiality scores given by participants in the experiment; that is, they test for a statistically significant association between the dependent variable (the materiality score) and explanatory variables for the score, ie the item's magnitude, likelihood and type (financial, environmental or social). Variables are also included in the models

Table 5.6: Responses to the case study by manipulation of magnitude and likelihood

Panel A: High Magnitude/High Likelihood	***n***	**(1) Materiality**	**(2) Confidence**	**(3) Likelihood**	**(4) Value creation**
Environment	101	63.47	76.53	68.69	60.50
Financial	96	78.44	77.71	69.84	79.79
Social	90	59.67	74.11	66.06	62.06
F-test		13.19***	0.82	0.77	19.10***
Panel B: High Magnitude/Low Likelihood	***n***	**(1) Materiality**	**(2) Confidence**	**(3) Likelihood**	**(4) Value creation**
Environment	99	52.68	70.61	58.79	51.26
Financial	96	65.52	73.54	56.25	68.91
Social	94	47.39	70.32	63.33	53.83
F-test		11.55***	0.81	2.27	12.63***
Panel C: Low Magnitude/High Likelihood	***n***	**(1) Materiality**	**(2) Confidence**	**(3) Likelihood**	**(4) Value creation**
Environment	90	54.33	70.11	67.33	52.44
Financial	96	64.79	74.79	63.75	64.48
Social	100	44.90	71.00	67.50	49.40
F-test		12.06***	1.39	0.91	8.00***
Panel D: Low Magnitude/Low Likelihood	***n***	**(1) Materiality**	**(2) Confidence**	**(3) Likelihood**	**(4) Value creation**
Environment	110	39.73	73.82	53.49	44.04
Financial	96	54.48	71.46	51.21	57.37
Social	82	35.85	74.15	57.28	42.20
F-test		11.49***	0.53	1.39	8.80***

*** significant at $p > 0.01$. The F tests in Panels A, B, C and D of columns 2 and 3 are not significant. *n* = number of responses.

Participants' scores for materiality are higher when the magnitude and likelihood of the experimental items are higher (ie high-magnitude or high-likelihood items) and when the item is a financial item.

so that magnitude and likelihood interact with item type (financial). This allows for an exploration of whether magnitude and likelihood have more explanatory power for financial items than for the other items (social and environmental).

In both models in Table 5.7, the dependent variable is the materiality score given for the item by participants ('Magnitude' in Table 5.4, Panel A, Column 1). In Model 1, *Magnitude_dum* and *Likelihood_dum* capture items that are assigned a high magnitude and high likelihood, respectively, in the case study. In Model 2, *Magnitude_perceived* and *Likelihood_perceived* are continuous variables based on the magnitude and likelihood scores given by each participant. *Fin_dum* represents a financial item. The Intercept term captures other explanatory factors not captured by the variables in the model.

Both models in Table 5.7 provide support for the univariate results reported in section 5.4.1 above. They show that participants' scores for materiality are higher when the magnitude and likelihood of the experimental items are higher (ie high-magnitude or high-likelihood items) and when the item is a financial item. Table 5.7 Model 1 shows that *Magnitude_dum*, *Likelihood_dum* and *Fin_dum* are all positive and significant (at the 1% level).

The coefficients for the interaction terms for magnitude and a financial item (*Fin_dum*Magnitude_dum*) and likelihood and a financial item (*Fin_dum*Likelihood*) are not significant, indicating that magnitude and likelihood do not have more explanatory power for the materiality ratings of financial items than for other items. This result differs from that suggested by the univariate results and shows the importance of exploring the research questions using multivariate models.

This relationship was explored further by using participants' assessment of magnitude and likelihood (hereafter 'perceived magnitude' and 'perceived likelihood') instead of the magnitude and likelihood as assigned in the experimental instrument. Table 5.7 Model 2 shows that *Magnitude_perceived* and *Likelihood_perceived* are both positive and significant (at the 1% level) and *Fin_dum* is not significant. They show that participants' scores for materiality are higher when their perception of the magnitude and likelihood of the experimental items are higher. However, the nature of the item (ie, whether it is financial item) does not affect the participants' assessment of materiality as it is likely that the nature of the item affects their perception of their likelihood and/or magnitude.

Table 5.7: Regression models

	Model 1		Model 2	
	Coeff	t-stat	Coeff	t-stat
Intercept	38.004	22.128***	8.277	2.543**
Magnitude_dum	12.168	6.130***		
Likelihood_dum	11.434	5.760***		
Magnitude_perceived			0.175	5.088***
Likelihood_perceived			0.469	11.650***
Fin_dum	15.824	5.321***	2.961	0.536
*Fin_dum*Magnitude_dum*	0.176	0.051		
*Fin_dum*Likelihood_dum*	0.181	0.053		
*Fin_dum*Magnitude_perceived*			0.100	1.688*
*Fin_dum*Likelihood_perceived*			0.122	1.813*
n (observations) =	1,150		1,144	
Adjusted R-squared	0.141		0.290	
F-stat	38.857		94.203	
Prob (F-Stat)	0.000		0.000	

*** significant at p > 0.01, ** significant at p > 0.05, * significant at p > 0.10

Perceived magnitude and perceived likelihood have more explanatory power for the materiality ratings of financial items than for other items.

In contrast to Model 1, the coefficients for the interaction terms for magnitude and a financial item (*Fin_dum*Magnitude_dum*) and likelihood and a financial item (*Fin_dum*Likelihood*) are significant (at the 10% level) indicating that perceived magnitude and perceived likelihood have more explanatory power for the materiality ratings of financial items than for other items. This means that participants' perceptions about magnitude and likelihood were engaged in the process of determining a materiality score; participants' perceptions about magnitude and likelihood show that these factors were more important in determining the materiality of financial items than of other items. The differences between the results in Models 1 and 2 for the interaction terms again highlight the effect that the nature of the items has on the participants' perception of likelihood and magnitude.

Further tests explored whether the effects described above differ according to the experience of participants. Table 5.8 shows Models 1 and 2 for the subsample of auditors (Panel A) and preparers (Panel B). Participants were classified as auditors if they had worked only as an auditor. Table 5.8 shows that the work experience of participants has no impact on the significant variables of Model 1. However work experience is an explanatory factor for the results for perceived magnitude and perceived likelihood in Table 5.7 Model 2.

Table 5.8 (Panel B, Model 2) shows that magnitude coupled with a financial item (*Fin_dum*Magnitude_dum*) is significant (at the 10% level), and likelihood coupled with a financial item (*Fin_dum*Likelihood*) is significant (at the 5% level). That is, for participants with experience as auditors only (ie no experience as preparers) the

Table 5.8: Regression models (data from auditors and preparers)

	Model 1		Model 2	
Panel A: Auditors	**Coeff**	**t-stat**	**Coeff**	**t-stat**
Intercept	38.004	22.128***	8.277	2.543**
Magnitude_dum	12.168	6.130***		
Likelihood_dum	11.434	5.760***		
Magnitude_perceived			0.175	5.088***
Likelihood_perceived			0.469	11.650***
Fin_dum	15.824	5.321***	2.961	0.536
*Fin_dum*Magnitude_dum*	0.176	0.051		
*Fin_dum*Likelihood_dum*	0.181	0.053		
*Fin_dum*Magnitude_perceived*			0.100	1.688*
*Fin_dum*Likelihood_perceived*			0.122	1.813*
n (observations) =	1,150		1,144	
Adjusted R-squared	0.141		0.290	
F-stat	38.857		94.203	
Prob (F-Stat)	0.000		0.000	
Panel A: Auditors	**Coeff**	**t-stat**	**Coeff**	**t-stat**
Intercept	38.004	22.128***	8.277	2.543**
Magnitude_dum	12.168	6.130***		
Likelihood_dum	11.434	5.760***		
Magnitude_perceived			0.175	5.088***
Likelihood_perceived			0.469	11.650***
Fin_dum	15.824	5.321***	2.961	0.536
*Fin_dum*Magnitude_dum*	0.176	0.051		
*Fin_dum*Likelihood_dum*	0.181	0.053		
*Fin_dum*Magnitude_perceived*			0.100	1.688*
*Fin_dum*Likelihood_perceived*			0.122	1.813*
n (observations) =	1,150		1,144	
Adjusted R-squared	0.141		0.290	
F-stat	38.857		94.203	
Prob (F-Stat)	0.000		0.000	

*** significant at p > 0.01, ** significant at p > 0.05, * significant at p > 0.10

A behavioural experiment with auditors and accountants explored how their assessments of an item's materiality were affected by its magnitude and likelihood.

magnitude and likelihood of items is not more strongly associated with materiality scores for financial items than for other items. In contrast, participants with broader corporate experience (which may also include experience as an auditor) are more influenced by the nature of items. One explanation of the difference is that the results reflect the nature of the participants' current jobs. That is, the auditors focus on the overall risk to the company while the preparer group is more concerned with the financial results of the company. There is, however, no further evidence available to corroborate this interpretation.

5.5 CONCLUSIONS

A behavioural experiment with auditors and accountants explored how their assessments of an item's materiality were affected by its magnitude and likelihood. The experiment included different types of item (relating to financial, environmental and social matters) to capture some of the matters that could be relevant when managers consider the six capitals discussed in the International <IR> Framework.

The findings showed that participants' scores for materiality were higher when both the magnitude and likelihood of the experimental items were greater and when the item was a financial item. The results indicated that magnitude was more influential than likelihood in materiality judgements when the two concepts interacted. Participants' perceptions about the magnitude and likelihood of items were more strongly linked to the materiality of financial items than of environmental and social items, and this effect was stronger for accounting professionals (not including auditors) in the study. A limitation of the experiment is that the participants were professional accountants and thus possibly inclined to focus on financial materiality, owing to their training and experience. Future research could usefully conduct the experiment with investors to explore their perceptions on this topic.

The evidence complements the earlier stages of the study in several ways. First, the experiment extends the earlier work by considering the concepts of magnitude and likelihood, which had not been explicitly considered in the earlier stages. Second, the experiment provides direct evidence based on participants' judgements and decisions in a case study. This evidence is of a different nature to the interviewee responses or data from published documents. The evidence stemming from the experiment also adds to the academic literature about financial and non-financial materiality judgements and the use of non-financial data (see Messier et al. 2005; Moroney and Trotman 2015).

Models 1 and 2 in Table 5.8 examine the explanatory factors for the materiality scores given by participants. Model 1 examines the effects of the items' magnitude, likelihood and type on the materiality score. Model 2 examines the effects of the participants' perceptions of the magnitude and likelihood of items on the materiality score. The dummy variables *Magnitude_dum* and *Likelihood_dum* capture items that are assigned a high magnitude and high likelihood, respectively, in the case study. *Magnitude_perceived* and *Likelihood_perceived* are continuous variables based on the magnitude and likelihood scores given by each participant. *Fin_dum* is a dummy variable that takes the value of 1 when the type of item is financial. Models in Panel A include data from auditors (ie any participant whose professional experience is only as an auditor). Models in Panel B include data from preparers. Finally, the evidence is relevant to practice and implementation of <IR> principles because the experiment is based on manipulation of three types of information that can be linked to some of the capitals that are basic concepts in the International <IR> Framework.

6. Conclusions

The development of <IR> is being guided by the IIRC and the International <IR> Framework, which builds on a range of other initiatives for improving financial and non-financial reporting developed by practitioners, academics, regulators and professional organisations.

6.1 INTRODUCTION

The development of <IR> is being guided by the IIRC and the International <IR> Framework, which builds on a range of other initiatives for improving financial and non-financial reporting developed by practitioners, academics, regulators and professional organisations. The aim of this study is to present evidence about current <IR> practices and to identify issues experienced by companies that were early adopters of <IR>, specifically in relation to the materiality determination process and achieving conciseness in integrated reports. The study's findings should be useful for companies wanting to develop integrated reports and for standard setters, regulators and others that seek to improve corporate reporting through greater application of <IR> principles.

This study provides preliminary evidence because <IR> is widespread in only one country, South Africa, where listed companies report under a 'comply or explain' regime. Outside South Africa, companies are generally involved in <IR> on a voluntary basis. Their reporting reflects the choices made by company management about disclosure, albeit within existing national regulatory frameworks for financial reporting and various forms of guidance about narrative reporting and sustainability reporting. The companies providing corporate reports from which data was collected were often leaders and innovators in <IR>. Thus, they may be very different from other companies or companies that may produce integrated reports in the future. The participants in the behavioural experiment were experienced accountants (working as auditors and in business accounting and management roles) with experience in financial and non-financial reporting, but few had specific <IR> experience.

Nevertheless, the study is informative about current reporting practices and issues in relation to materiality and conciseness in <IR>. A strength of the study is that the evidence is drawn from current leaders in <IR> through interviews and published reports. This data is

Some interviewees expressed concerns about the potential legal liability arising from disclosure of new types of information in accordance with the International <IR> Framework, particularly forward-looking information.

supplemented by direct observations of behaviours of professional accountants and auditors in a behavioural experiment about magnitude and likelihood in determining materiality of financial and non-financial items. Given that these important concepts were generally not referred to in the interviews or the published reports, the third stage of the study adds to the first two stages and extends understanding of materiality determination in practice.

The study also identifies challenges for the development of <IR>. These challenges are discussed in the next section, along with various possible responses/solutions.

6.2 CHALLENGES FOR <IR>

6.2.1 Regulatory frameworks

Some companies have issued reports entitled 'integrated report', and others are issuing annual reports or sustainability reports that follow some of the principles of <IR>. Most of these companies are also producing other reports to meet various statutory requirements. One of the key challenges for <IR> is to determine where integrated reports fit within the national corporate reporting regulatory frameworks. The issues include the following:

- How do integrated reports fit within the requirements for other reports and the concepts used in those reports?
- How can useful information in integrated reports be promoted within existing legal reporting frameworks?

Some interviewees expressed concerns about the potential legal liability arising from disclosure of new types of information in accordance with the International <IR> Framework, particularly forward-looking information. One interviewee mentioned the problems of bringing concepts from financial reporting (such as materiality) into <IR> and thereby potentially reducing the usefulness of integrated reports.

The role for <IR> must emerge within each jurisdiction, with the future direction of travel to be determined through dialogue between the appropriate regulatory bodies in conjunction with reporting entities and their stakeholders. A variety of approaches are possible, ranging from no regulatory intervention to scenarios where <IR> is directly mandated (eg South Africa). Disclosure of information not related to financial performance is also promoted through management commentary guidance, the status of which varies between countries. For example, listed companies in the US and Canada are required to provide a management discussion and analysis (MD&A) report; Australian companies provide a review of operations and corporate governance information; and UK companies provide a strategic report.[29] Clearly national bodies such as security market regulators, financial reporting standard setters and stock exchanges can influence the extent of development of <IR> in their jurisdictions, and there is scope for more research in this area (see eg Frías-Aceituno et al. 2013). Depending on the positions taken by national regulators, there is potential for the International <IR> Framework to be more influential, particularly because the Framework is still relatively new, being was released only in December 2013.[30] In addition, the Framework could be more useful if supported by more promotion and education at a national level, for example by professional accountancy bodies or organisations representing shareholders and investors.

Currently, some companies are providing integrated reports because they see a demand. Meanwhile, other companies state that they are not producing an integrated report because of specific features of the reporting environment such as the legal risk that forward-looking disclosures of the type that may be expected in integrated reports will increase litigation risk. Further research on how <IR> currently fits, and could fit in the future, within national regulations at a country level would be useful for the future development of <IR>. The issue of risks of disclosure (such as the costs associated with litigation risk) could be a relevant area for future investigation. For countries without 'safe harbour' protections for directors' disclosures, such regulatory provisions may assist companies to provide more forward-looking disclosures and other disclosures relevant to <IR>.

29 Australian companies follow guidance for reporting about corporate governance (a 'comply or explain' regime) that includes recommendations relating to sustainability and stakeholder engagement. GRI (2013b) suggests that this may promote aspects of <IR>. In the UK some companies are required to prepare a strategic report, which has the objectives of providing (1) context for the related financial statements, (2) insight into the entity's business model and its main objectives and strategy, (3) a description of the principal risks the entity faces and how they might affect its future prospects, and (4) links to the location of complementary information (FRC 2014). Some of these topics can be aligned with the content of integrated reports.

30 The corporate reports reviewed in the present study were from 2012/13 so they predate the release of the International <IR> Framework.

Some interviewees commented that meeting the needs of a range of diverse users with one report was challenging.

6.2.2 Business complexity and user expectations

Some interviewees enjoyed being leaders in <IR> and reported positively about their <IR> experiences. Nonetheless, some referred to the reluctance of others in their organisations to become involved because the benefits were not clear to them or they had vested interests in maintaining the present situation. Some interviewees commented that meeting the needs of a range of diverse users with one report was challenging. It is worth noting that the International <IR> Framework clearly identifies providers of financial capital as the primary audience of <IR> reports. However, the question of how the information needs of this primary audience might be reconciled with the information needs of other stakeholder groups may have to be addressed in order for the <IR> movement to be successful. One respondent said that although the company was attempting to follow <IR> principles, the complexity of the business (in operations and global locations) created difficulties for presenting a concise report. The issues include how companies can provide a concise report that is not too broad to be useful and how they can meet the needs of a range of stakeholders with one report.

Some companies addressed this issue by making one report the 'integrated report' (for example, by changing the content and format of the annual report). If other reports were required (eg a 20F report required for a US stock exchange listing), those reports focused on meeting the relevant regulatory requirements. The latter reports were viewed as compliance documents while the integrated report focused on communication with investors and other stakeholders.

Stakeholder expectations can be managed by explaining the purpose of the various reports and the content of each. Companies can use their websites to provide access to the various reports and to supporting documents that provide more detail about matters touched on in the integrated report, so that users who wish to obtain more information on a topic can do so. Interactive reports were seen by interviewees as more timely and engaging and tailored to individual user's information needs. This was particularly important for interviewees who were concerned that <IR> would lead to 'just another report' that was not read by investors, who obtained much of their information about the company from other, more timely, sources.

Several interviewees commented on the benefits of the current relative freedom in <IR> because <IR> is not specifically regulated in many countries. A challenge for the future is finding the right balance between guidance and prescription so that transparent and balanced disclosures are encouraged but any mandatory requirements, if introduced by countries, do not lead to a compliance mindset or tick-box approach.

6.2.3 Costs and benefits of change

The interviews suggest that <IR> is a potentially expensive activity because of the resources involved and the degree of cultural change necessitated in an organisation. <IR> involves setting up systems to collect new data, measuring and analysing items not included in current systems and ensuring the accuracy of this data. In addition, interviewees point to new terminologies (eg value creation, capitals) and ways of thinking and interacting within the organisation. Companies involved in <IR> may consider that the benefits outweigh the costs, particularly in promoting 'integrated thinking', leading to management and operational synergies in the company. In addition, there may be cost savings in reducing the number of reports produced annually. Nonetheless, for some companies, the extent of change required may be a barrier to the development of <IR>. Difficulties include how some items of information might be evaluated and measured and how change might be successfully introduced and managed in an organisation.

Given the interest in <IR> and the activities of early-adopting companies, there is scope for companies to learn from others' experiences. Companies reporting benefits from adopting <IR> may also encourage internal and external parties to support adoption.[31] Demand from stakeholders may provide the impetus companies need to invest in new systems for data collection and analysis, which may have benefits for the company beyond those attached to providing an integrated report. In addition, senior management may lead the change in embracing <IR> and hence in breaking down 'silos' in the company and creating a more interconnected organisation.

31 See for example GRI (2013b) a report of survey data from 14 entities that were early adopters of <IR>.

Some audit firms have relevant experience from involvement in providing assurance on sustainability reports or reviewing management commentary reports for material inconsistencies with audited financial statements.

6.2.4 Audit and assurance

Audit firms are also potential beneficiaries of <IR>. These firms can have a role in assisting clients, within the bounds of independence constraints, to develop their systems and practices for <IR>. In addition, companies may seek assurance on the information contained in integrated reports. Some <IR> information may present auditing challenges, although previous experience of providing assurance on corporate social responsibility and sustainability reports or reviewing management commentary reports for material inconsistencies with audited financial statements should prove relevant. The assurance process has the potential to improve internal and external stakeholders' confidence in <IR>. On the other hand, the involvement of auditors may also have the possible effect of encouraging standardisation of reporting practices. The IIRC could do more to clarify what the roles of auditors and assurance providers for <IR> should be and how companies can demonstrate quality in reporting, that is, provide accurate and unbiased information that is complete, comparable and transparent.[32]

Some audit firms have relevant experience from involvement in providing assurance on sustainability reports or reviewing management commentary reports for material inconsistencies with audited financial statements. There will be opportunities for some firms to provide training to others for audit, assurance and internal controls over systems for internal data collection, for which best practice is still emerging.[33] Audit firms can benefit from guidance provided by standard setters, regulators and other bodies that choose to become involved in <IR>. Experienced audit practitioners will also be able to contribute to the development of appropriate guidance, which will promote the development of <IR>. Support and guidance from auditors and professional associations through guidance statements and education may assist senior managers and directors to be more confident that the output of reporting systems provides high-quality information that meets relevant requirements for faithful representation, comparability and transparency.[34]

6.3 CONTRIBUTION TO ACADEMIC LITERATURE AND STUDIES ABOUT <IR>

This study adds to existing professional and academic literature in a number of areas. First, this report adds to previous publications by accounting firms and professional accounting bodies and extends studies that have provided guidance and feedback about <IR> (see, for example, Deloitte 2012; GRI 2013b; KPMG 2012). Insights about <IR> practice have been drawn from interviews with early adopters and others (Higgins et al. 2014; Stubbs and Higgins 2014; van Bommel 2014). The present work extends earlier work through its focus on the topics of materiality and conciseness, which are fundamentally important for the future development of <IR>. There is scope to add to this area of research through interviews with investors and other users of integrated reports.

Second, this work builds on the findings in earlier academic studies. A large stream of literature considers disclosure in annual reports and sustainability reports (see Gray et al. 1995; Healy and Palepu 2001), but there are fewer studies of integrated reports. This report provides information about the format of reports being produced by early-adopting companies and provides evidence about the materiality determination process, as described in corporate reports. This complements information from the interviews and those of Stubbs and Higgins (2014). The present study extends the current <IR> literature about content and quality of <IR> reports (Solomon and Maroun 2012; van Zyl 2013) by focusing on materiality and conciseness in reporting and providing insights drawn from public reports and interviews. Many studies use one or the other method, but here the findings of the review of reports are triangulated with the evidence collected in interviews to provide a deeper understanding of the issues.

Third, this study contributes to the literature that has explored the application of the concept of materiality and the usefulness of non-financial (for example, environmental and social) information for shareholders and investors. Prior studies of

32 For more information about the debate on the role of independent assurance and trust and credibility in <IR>, see IIRC (2015).

33 See Cheng et al. (2014) for discussion of assurance of integrated reports.

34 For further discussion about <IR> challenges and responses to them see EY (2013) and IIRC and AICPA (2013).

There will be demand for evidence from research exploring the usefulness of disclosures from the perspectives of different users, and considering the quality of the information provided.

auditors explore the use of non-financial information and qualitative factors in determining materiality. For example, Krogstad et al. (1984) and Carpenter and Dirsmith (1992) examine the impact of financial and non-financial items, the size and type of transactions, and professional experience on materiality judgements. More recent work considers judgements about materiality of non-financial information and materiality in <IR> (Cheng and Green 2015; Moroney and Trotman 2015). This report's findings about the impact of magnitude and likelihood on judgements of materiality; how the concepts interact; and the effect of types of item and interviewees' current work experience extend current evidence in this area. Future research opportunities include conducting behavioural experiments with users of corporate information such as investors. Their views may differ from those reported for the accountants who participated in the present study.

This study also suggests a number of areas for future research. The review of corporate reports points to both strengths and weaknesses in the materiality disclosures of leading <IR> companies. There will be opportunities to track the development of <IR> over time, as companies develop their skills in this area and more companies become involved. With the passage of time, scholars will be able to explore the impact of the International <IR> Framework on content and style of disclosures using text analysis tools. There will be demand for evidence from research exploring the usefulness of disclosures from the perspectives of different users, and considering the quality of the information provided. Other research opportunities relate to the development of measurement systems for non-financial information and the audit and assurance of the information contained in integrated reports. (For further suggestions for <IR> research, see Cheng et al. 2014 and de Villiers et al. 2014.)

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Appendix A

APPENDIX A1: INTERVIEW QUESTIONS

We have contacted you with some questions about your firm's integrated reporting. Please answer the following questions in relation to your firm in the last 12 months:

1. What is the location of your firm's Integrated Report?
2. Who are the proposed users of the report?
3. Which people or sections are involved in preparing the report?
4. How do you decide about what is included in the report?
5. How do you determine whether an item is material?
6. How do you achieve conciseness in your report?
7. In what ways do legal and regulatory requirements in your country affect the preparation of the report? Do listing requirements affect preparation of the report?
8. What challenges have you experienced in preparing the report?

APPENDIX A2: INTERVIEW THEMES AND SUBTHEMES

Theme	Subtheme
Location	Does the company do <IR>? What reports are issued (names)? When was <IR> adopted? Benefits of <IR>?
Users	Shareholders Investors Stakeholders Customers Employees Providers of capital
Preparers	Finance/Treasury/Company Secretary Investor relations/marketing/corporate communications HR/health/safety Sustainability/CSR Operating divisions/geographic locations Executives/Board of Directors Legal Auditors Consultants
Content	Voluntary/Mandatory/General reporting principles Frameworks (eg GRI) Company strategy Consistency between reports Audience Medium
Material Items	Process for determining/timing Judgement/discretion Financial materiality Strategy/Goals; report against goals Investor needs Talk to stakeholders (external) Internal parties Auditor influence Risk Committee
Conciseness	Redrafting/consultation Judgement Number of items identified Competitor review User needs/audience Business/issue complexity Business/financial risk (eg IAS 39) Forward looking (litigation risk) Medium used (paper vs web) Length Pages vs minutes to read Regulatory requirements Complimentary information sources
Legal/ Regulatory	Mandatory compliance/review of legislation Litigation risk Balanced report (bad news; report negatives) Legal advisors Corporate Governance Code Auditors
Challenges	Multiple reports, multiple users: one or more documents? Yearly evolution Including material items vs being concise Diversity in user requirements Forward looking/litigation risk Balanced content (good/bad; legal/non-legal) Cultural change in organization to achieve <IR>
Leader/ Follower	Voluntary - leader Awards Integrated company Assurance Quantifying non-financial information

APPENDIX B: CORPORATE REPORTS – CODING RULES

1. Sample: See 2013 Masterlist (Excel file) consisting of companies in:
    a. <IR> Examples Database
    b. <IR> Business Network
    c. JSE listed companies in the FTSE/JSE All-Share Index

2. From the sample, find all companies that have a report titled 'Integrated Report' or state in their annual report that they do integrated reporting.

3. Review the integrated report (or equivalent) for the description of the company's materiality determination process ie the steps the company took to determine materiality. Where this process is detailed within another report eg the sustainability report, code the description included in the other report.

4. Complete the checklist given to you in the Excel file with the following information:
    a. The name of the company.
    b. Whether the company has an integrated report; or annual report with an integrated report comment; or another report eg sustainability report.
    c. Whether the materiality determination is given within the integrated report (annual report equivalent) or is linked to another report.
    d. Title of any additional reports containing the materiality determination disclosure.
    e. Location of materiality determination
        i. Page numbers
        ii. Section heading
        iii. Page heading

    f. Indicate (Y/N) if the text about the materiality determination process includes the following:
        i. Identify process: does the company identify (explain or describe) the process it used to determine if an item is material (Y/N)?
        ii. Evaluation process: does the company explain or describe the process it used to evaluate whether an item is material (ie explain why the item is material or what makes the item material) (Y/N)?
        iii. Prioritising: does the company detail the process it uses to prioritise (rank) material items (ie how it ranks the material items) (Y/N)?
        iv. Disclosure of material items: does the company provide a list of material items (Y/N)?

    g. Detail the presentation methods used when describing the materiality assessment process:
        i. List (L)
        ii. Figure (F)
        iii. Table (TA)
        iv. Text (TX)

PI-MATERIALITY-CONCISENESS-IR