International Conference on Economics, Entrepreneurship and Management 2019 (**ICEEM2019)**

Langkawi **July 6, 2019**

INTEGRATED REPORTING AND GOVERNMENT-LINKED COMPANIES: EVIDENCE FROM MALAYSIA

Nathasa Mazna Ramli

Faculty of Economics and Muamalat, Universiti Sains Islam Malaysia (USIM), Bandar Baru Nilai, 71800 Nilai Negeri Sembilan, Malaysia

Email: nathasa@usim.edu.my

Abstract. Integrated Reporting (IR) is a new reporting concept and is a principle-based reporting. IR is holistic, strategic and relevant which represents a more meaningful reporting. The objective of this study is to examine the adoption of IR in the annual reports of top 100 listed companies in Malaysia. Based on 2017 annual reports, the examination is based on IR scores which are developed based on eight elements of IR. In addition, this study also examines whether there is a difference on the reporting based on the ownership of the companies, in particular whether the company is owned or linked with the government. It is expected that this study could enhances the IR literature, especially provides an evidence from Malaysia where the ownership structure is different from other developed countries.

Keywords: Integrated Reporting, Ownership Structure, Government-linked Companies

1. Introduction

Published reports, such as annual reports are widely regarded as an important means of discharging accountability in the corporate and government sectors. These reports may be one of the means by which companies can improve stakeholders' perceptions of their accountability. Business stakeholders such as shareholders, investors and the economy at large need a high-quality and value-relevant reports that contains information from companies. This is to ensure that the allocation of resources are efficient and effective, to encourage transparency and ethical practice of business. Empirical evidence shows that high level of transparency and disclosure can increase confidence among decision-makers. However, published reports like annual reports should not only contain financial information, but also non-financial information.

These leads to proposition for all type of organisations to adopt an integrated reporting (IR), which covers more than financial elements. IR is a new reporting concept that is holistic, strategic and relevant which represents a more meaningful reporting. The new initiative is said to have the potential to change the landscape of corporate reporting (Zhou, Simnett and Green, 2017). IR framework is an initiative by The International Integrated Reporting Council (IIRC), which is a 'global coalition of regulators, investors, companies, standard setters, the accounting profession and NGOs' (IIRC, 2013). The reporting framework is different from sustainability reporting, which also highlights non-financial information in its reports. Sustainability reporting can be viewed as a component of sub-set of IR. IR would include additional non-financial information such as information relating to strategy and resource allocation. IR is also more than combining existing disclosure into a single report. IR assists stakeholders to understand the value of organisations and how value is created. It is an emerging concept; therefore empirical research about it is both recent and sparse.

This study examines the adoption of IR in Malaysian listed companies. In addition, this study also focuses whether there is a difference on the reporting based on the ownership of the companies. Previous studies has found that ownership structure, such as government ownership, family ownership, foreign ownership and institutional ownership has influences on corporate disclosures (e.g. Alhazaimeh et al., 2014, Haniffa and Cooke, 2002, Aljifri et al., 2014, Khan et al. 2013). Companies with high levels of government ownership is related to low levels of disclosure. This is due to the strong political connection of the companies which can offer protection against greater scrutiny and discipline by weak regulatory framework (Ebrahim & Fattah, 2015) Companies with higher government ownership also might have easy access in obtaining funds from the government, thus have less motivation to disclose information in attracting investors. In contrast, companies with high level of government ownership are under greater public scrutiny, therefore the companies has more to pressure in disclosing more information (Alhazaimeh et al. 2014, Ntim et al., 2012) .

The remainder of the paper is organised as follows. Next section presents a review of the relevant literature relating to IR. The research method is outlined in Section 3. Section 4 presents the results and discussion. The final section presents the conclusions and directions for future research.

2. Integrated Reporting

IR is a new reporting phenomenon with the aims of advancing and enhancing corporate reporting. The reporting framework emphasis on the interconnections between different types of information which currently seperately reported. There are various definition of IR. Busco, et al. (2013) stated that an IR is a process that results in communicating through the annual integrated report which creates value over time. IR offers a concise, stand-alone communication about how an organization's strategy, governance, performance and prospect lead to the creation of value over the short, medium and long term. IR is a management and communication tool for understanding and measuring how organizations create value now and in the future. Therefore, it can be concluded that IR is a concept that has been created to better articulate the broader range of measures that contribute to long-term value and the role organization plays in society. Specifically, IR is defined as:

IR demonstrates the linkages between an organization's strategy, governance and financial performance and the social, environmental and economic context within which it operates.

By reinforcing these connections, IR can help business to take more sustainable decisions and enable investors and other stakeholders to understand how

> *an organization is really performing*. (International Integrated Reporting Committee 2011)

Rossouw (2011) mentioned that IR is a disclosure of forwards looking information, assurance on the quality of this type of information, annual presentation, positive aspect and challenges, holistic and integrated view on financial and sustainability elements. In addition, IR also covers performance, assurance on material sustainability or non-financial issues. IR defined differently by scholar and improved over time. Robert et al. (2011) mentioned that IR provides benefit to the management as it gives better understanding and clearly articulated statements about the relationship between financial and non-financial performance. IR also provides better risk management and better engagement with current and prospective employees and other stakeholders.

IIRC (2013) highlighted the key underlying principles, namely materiality, conciseness, and connectivity. The principle of materiality assists to re-arrange companies report by including only substantial matters affecting a company's value-creation ability (Zhou, Simnett and Green, 2017). The principle of conciseness focuses on the importance of cross-checking the content of the report and transformed standard information to other medium. The principle of connectivity principle relates to that the relationships among key elements and dimensions. Several studies have highlighted the benefits of IR. Owen (2013) summarized that IR gives review of the organization, its governance structure, its core activities and how it creates and adds value for stakeholders. Robert and Shachzman (2011) viewed that IR assists management in internal resource allocation decision, provide greater engagement with stakeholders and lower reputational risk. Robert et al. (2011) stated that IR provides benefit to the management as it gives better understanding and clearly articulated statements about the relationship between financial and non-financial performance. IR also provides better risk management and better engagement with current and prospective employees and other stakeholders.

By time, IR have wider definition and concept. Villiers and Rinaldi (2014) found that rapid development of IR policy, and early developments of practice, present theoretical and empirical challenges because of the different ways in which IR is understood and enacted within institutions.Flower (2015) suggested a guidelines of an IR. The guidelines highlighted the importance of integration the voices and values of different communities and natural world, not a narrow range of corporate dialects. Besides, the guidelines proposed the IR to be an appropriate blend of scientific, economic financial, statistic, ethical, and aesthetic narratives which enable flexible engagements involving different stakeholders representing plurality of interests, epistemological and ontological perspectives. Melloni (2017) discused about disclosure conciseness, completeness and balance in integrated reports. The research found that early adopters show that in the presence of an organization's weak financial performance, the IR tends to be significantly longer and less readable (i.e., less concise), and more optimistic (i.e., less balanced). Besides, the research found also less information on their sustainability performance of the early adopter of IR.

3. Research Methodology

This study focuses on the top 100 companies listed on Bursa Malaysia as at 31 December 2017. After eliminating several companies due to data unavailability, the final data contains 90 listed companies. The data are extracted from the annual reports for year ended 2017 which were availble on the company's website.

This study adapts an integrated reporting score, describes as IRSCORE. The score was constructed by Lee and Yeo (2015). Due to the absence of theoretical guidance about how to weight each measure in constructing an aggregated IR score, Lee and Yeo (2015) construct a composite IR index by assigning equal importance (and thus, equal weights) to each of the eight content elements in the IR framework. In particular, for company for each year in this sample, the variable IRSCORE is the equally weighted average of the (1) Organizational overview and external environment; (2) Governance; (3) Business model; (4) Risks and opportunities; (5)Strategy and resource allocation; (6) Performance; (7) Outlook; and (8) Basis of preparation and presentation. Each content element contains 5 questions to assess the quality of the IR disclosure. The questions are as Table 1.

Table 1: Questions to Assess the Quality of IR Disclosure

Questions based on categories and items of disclosure
<u>Organizational overview and external environment</u>
What is the organisation's mission, vision, culture and values and the circumstances under which it operates?
What is the organization's competitive landscape and market positioning?
How is the organization's ability to create value in the short, medium and long-term affected by significant factors in the external environment?
Does the integrated report provide information about the effects of significant external environmental factors on the organization such as legitimate needs and interests of stakeholders, macro and micro economic conditions including economic stability, globalization and industry trends, market forces, technological changes, societal issues, environmental challenges, political and regulatory environment?
Does the integrated report link the significant factors affecting the external environment to the availability, quality and affordability of capitals that the organization uses or affects?
<u>Strategy and resource allocation</u>
What is the organisation's short, medium and long term strategic objectives and how does it intend to get there?
What are the organisation's resource allocation plans?

Does the organization link its strategy and resource allocation plans to its business model and changes needed to implement its strategy?
Does the organization link its strategy and resource allocation plans to external environmental influences, stakeholder engagement and risks and opportunities identified?
What differentiates the organization in terms of competitive advantage and its ability to create value?
Business model
What is the organization's business model?
To what extent does the business model create value for the organization in the short, medium and long term?
What information does the integrated report provide about the inputs (stock of capitals), business activities, outputs and outcomes of the business model?
How is the business model linked to other content elements such as strategy, risks and opportunities and performance?
For organizations that operate in multiple businesses with multiple business models, what is the extent of connectivity and synergistic benefits that exist amongst the different business models?
Governance
How does the organization's governance structure support its ability to create value in the short, medium and long term?
What information does the integrated report provide about the organization's leadership structure including its skills and diversity?
What information does the integrated report provide about the organization's specific processes for strategic decision making, risk management and addressing of ethical and integrity issues?
How is the organization's culture, ethics and values reflected in its use of and effects on the capitals including its relationships with key stakeholders?
Are the remuneration and incentives of directors and senior executives linked to value creation and to the organization's use of capitals in the short, medium and long-term?
Risks and opportunities
What are the specific opportunities and risks that affect the organization's ability to create value over the short, medium and long term?

What information does the integrated report provide about the organisation's key risks which include strategic, supply chain, political, financial, human resource, environmental, information technology and reputation risks?
Does the organization identify the specific sources of risks and opportunities, assess the likelihood that the risk or opportunity will come to fruition and determine the magnitude of the effect if it does?
What specific action steps does the organization take to mitigate or manage key risks or create value from key opportunities including identifying associated strategic objectives, strategies, policies and KPIs?
Does the organization use the guiding principle of materiality in reporting any real risks that are fundamental to the ongoing ability of the organization to create value even if their probability of occurrence may be small?
Performance
To what extent has the organization achieved its strategic objectives?
What are the organization's outcomes in terms of effects on the capitals used in the value chain (both positive and negative)?
Does the integrated report provide information on outcomes such as customer satisfaction, shareholder return, contribution to taxes, job creation, employee development and engagement, improved living standards, impact on environment and the organization's license to operate?
Does the integrated report discuss the state of key stakeholder relationships and how the organization has responded to meet key stakeholders' legitimate needs and interests?
To what extent does the integrated report combine financial performance with performance regarding other capitals such as human, natural, intellectual, manufactured and social?
Outlook
What challenges and uncertainties is the organization likely to encounter in pursuing its strategy?
How is the organisation equipped to respond to critical challenges and uncertainties that are likely to arise?
What are the potential implications for the organization's business model and future performance?
Does the discussion on potential implications include the effects of the external environment, risks and opportunities on the achievement of strategic objectives?
Does the discussion on potential implications include the availability, quality and affordability of capitals and their effect on the organization's ability to create value over time?

Basis of preparation and presentation
How does the organization determine what matters to include and evaluated?
Does the integrated report provide a summary of the organization's materiality determination process and key judgements adopted?
How does the integrated report identify its reporting boundary and explain how it is determined?
Are material risks, opportunities and outcomes attributable to or associated with other entities or stakeholders included in the integrated report to the extent that they materially affect the ability of the financial reporting entity to create value?
Does the integrated report provide a summary of the significant frameworks and methods used to quantify or evaluate material matters included in the report?

Source: Lee and Yeo (2015)

The study re-align the score by ranging it from 0 (non-compliance with IR framework) to 3 (strong compliance with IR framework). Based on our scoring procedures, the minimum IRSCORE is 0 and the maximum IRSCORE is 15 for each dimension. Higher IRSCORE denotes better quality of IR. Therefore, inline with the IR framework and guiding principles.

This study refers to the top 30 shareholders disclosed in the annual reports in determining whether the companies are a Government-Linked Company. In addition, this study also cross-referred with other sources to ensure the consistency of the ownership structure of the companies.

4. Findings

The following table presents the IR disclosure index score (IRSCORE) for the companies in the sample. The highest IRSCORE is for the outlook dimension, where the score is 13.01. This shows that the outlook of the companies are highly being presented in the annual reports. The lowest IRSCORE is for the basic of preparation and presentation. It seems that the basis of preparing of the reports are low, which is translated into 42.8%.

Table 2: IR Disclosure of Malaysian Companies

	O'tional overview and external environment	**Strategy and resource allocation**	**Business model**	**Governance**	**Risks and opportunities**	**Performance**	**Outlook**	**Basis of Preparation and presentation**
Mean	10.69	12.86	10.81	12.47	11.90	12.94	13.01	6.42
Median	11	13	10	13	12	14	14	5
Max	15	19	15	15	15	15	15	15

Min	4	6	4	6	5	6	5	2
Standard Deviation	3.0061	2.2289	3.1195	2.0720	2.8247	2.0075	2.2925	3.4960

Table 3 presents the IR disclosure index score for Government-linked Companies (GLCs) and non-GLCs.

Table 3: Average IR Disclosure of GLCs and Non-GLCs

Dimesion	**GLCs**	**Non-GLCs**
Organizational overview and external environment	11	12
Strategy and resource allocation	13	14
Business model	11	12
Governance	13	14
Risks and opportunities	12	13
Performance	13	15
Outlook	13	15
Basis of preparation and presentation	7	6
Total	94	101
Percentage	79%	84%

The results show that on average, the total IR score non-GLCs is higher than GLCs, where the percentage of total score is 84% for non-GLCs and 79% for non-GLCs. Non-GLCs scores 100% for two dimensions, namely for performance and outlook dimensions. Both type of companies scores low for the organizational overview and external environment dimension and business model dimension, where both type of companies percentage scores of 73% and 80% respectively.

The above results shows that the top companies in Malaysia has generally adoted IR. However, each dimension of IR has not be covered sufficiently. In addition, there is only slight difference between the IRSCORE of GLCs and non-GLCs. However, it can be concluded that both type of companies have adopts IR framework in its annual reporting.

Conclusion

In business environment, corporate reporting plays an important function. Companies are disclosing more on non-financial information. IR can be considered by companies as part of their business strategy. Indeed, IR is the current initiative with the intention of meeting the stakeholders' demands of transparency. This study seeks to examine the adoption of IR in

Malaysian listed companies. In addition, the study also examine whether there is difference in the IR between GLCs and non-GLCs listed in Malaysia. The examination is based on IR scores which are developed based on eight elements of IR. The findings also shows that both type of companies has adopted IR in their annual reporting. However, the scores of GLCs are lower than non-GLCs. This study has laid the initial groundwork for several strands of future research. Since this study was based on only top companies in Malaysia, future research could focuses on other annual reporting of listed companies. Comparison between the listed and unlisted companies would be interesting as to determine whether the listing status has any effect of IR disclosure. In addition, the perception and understanding of the board and management also needs to consider in relation to IR. As a conclusion, analysis from multiple perspectives is needed to explore whether the IR Framework is a effective reporting practices for Malaysian companies..

Acknowledgement

The author would like to express our gratitude to Ministry of Higher Education for the grant provided to execute the project entitled Formulating Integrated Reporting Framework Islamic Social Finance Institutions (USIM/FRGS/FEM/32/50416).

References

Alhazaimeh, A., R. Palaniappan & M. Almsafir, (2014). The Impact of Corporate Governance and Ownership Structure on Voluntary Disclosure in Annual Reports among Listed Jordanian companies. ProcediaSocial and Behavioral Sciences, 129: 341-348.

Aljifri, K., & K. Hussainey, (2007). The determinants of forward-looking information in annual reports of UAE companies. Managerial Auditing Journal, 22(9): 881-894. http://doi.org/10.1108/02686900710829390

Buitendag, N. (2017). Firm characteristics and excellence in IR , South African Journal of Economic and Management Sciences, 2017, 629-637.

Busco, C., Frigo, M., Paolo Quattrone & Angelo Riccaboni, (2013). Redefining Corporate Accountability through – IR: What Happens When Values and Value Creation Meet? Strategic Finance, 33-41.

Eccles, R. & Krzus, M. (2010), Integrated reporting for a sustainable strategy, Financial Executive, March, pp. 29-32.

Financial Accounting Standards Board (FASB) Concepts Statement No. 4, (December, 1980).

Flower, J., (2015). The International IR Council: A story of failure, Critical Perspectives on Accounting, 2015, 1-17.

Frumkin, P. & Keating,E. (2002).The risks and rewards of nonprofit revenue concentration. Faculty Research Working Paper Series: Hauser Center for Nonprofit Organizations.

Gray, A. & Bill J. (1993). Codes of Accountability in the New Public Sector. Accounting, Auditing and Accountanbility Journal (3):52-67.

Haniffa, R.M., & Cooke, T, (2005). The Impact of Culture and Governance on Corporate Social Reporting. Journal of Accounting and Public Policy, 24(5): 391-430. http://doi.org/10.1016/j.jaccpubpol.2005.06.001

IIRC (2011), The International /IRS Framework, The International Integrated Reporting Council, London.

Khan, S.A., K.A. Al-Maimani & W.A. Al-Yafi, (2013). Exploring corporate social responsibility in Saudi Arabia: The challenges ahead. Journal of Leadership, Accountability and Ethics, 10(3): 65.

Lee, K.W. & Yeo, G.H.H. (2016). The Association between Integrated Reporting and Firm Valuation. Review of Quantitative Finance and Accounting, 47, 1221-1250.

Ntim, C.G., & T. Soobaroyen, (2013). Black economic empowerment disclosures by South African listed corporations: The influence of ownership and board characteristics. Journal of business ethics, 116(1): 121-138

Robert, G. E., & Saltzman, D. (2001). Achieving Sustainality Through Integrated. Social Innovation Review Summer, 56-61.

Rossouw, R., (2011). Integrating Sustainability Reporting, Presentation delivered at the Women in Finance Conference, South Africa, Available at http//www.slideshare.net

Sproat, P. (2005), The social impact of counter terrorist finance policies in the UK, Crime,Law and Social Change, Vol. 44, 441-464.

ns Development Programmes –UNDP (2012). Strategy for Working with the Private Sector.

Villiers, C., & Rinaldi, L., (2014). IR: Insights, gaps and an agenda for future research, Accounting, Auditing and Accountability Journal, 1042-1067./.

Zhou, S., Simnett, R., & Green, W. (2017). Does integrated reporting matter to the capital market? *Abacus*, 53(1), 94– 132.