J. Account. Public Policy 35 (2016) 437–452

Contents lists available at ScienceDirect

J. Account. Public Policy

journal homepage: www.elsevier.com/locate/jaccpubpol

Value relevance of accounting information under an integrated reporting approach: A research note

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A B S T R A C T

This research note aims to enrich our understanding regarding the market valuation implications of financial reporting under an Integrated Reporting (IR) approach. In order to do so, we focus on the Johannesburg Stock Exchange (JSE) and we examine whether the value relevance of summary accounting information (i.e., book value of equity and earnings) of firms listed on the JSE has enhanced after the mandatory adoption of an IR approach under the King III Report. Our study can be seen as a response to the recent calls for a closer investigation of the usefulness of the new reporting trend for investors. More specifically, our study can be seen as a response to the stance taken by the International Integrated Reporting Council (IIRC) Framework that the adoption of an IR approach improves the usefulness of financial reporting for investors. For our empirical tests we utilize a sample of 954 firm-year observations and employ a linear price-level model which associates a firm's market value of equity with its book value of equity and earnings. In line with the IIRC Framework's expectations, we find strong evidence of a sharp increase of the earnings' valuation coefficient. However, contrary to the Framework's stance, our results indicate a decline in the value relevance of net assets. Such a decline may be imputed to risks and/or unbooked liabilities that are revealed or measured more reliably after the introduction of an IR approach on the JSE. It should be noted, however, that despite its cause, the decline in the value relevance of net assets can be seen as a further argument in favor of the IIRC stance to assign equal importance to a wide

Abbreviations: IFRS, International Financial Reporting Standards; IR, Integrated Reporting; IIRC, International Integrated Reporting Council; JSE, Johannesburg Stock Exchange.

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http://dx.doi.org/10.1016/j.jaccpubpol.2016.04.004

range of "capitals," such as human, social and natural capital. We believe that our findings are of particular interest to a wide range of regulators, standards setters, practitioners, and academics but first and foremost to the JSE and IIRC.

1. Introduction

Integrated Reporting (hereafter IR) has lately attracted much attention among practitioners and policy makers across the world. Regulators and capital markets authorities have started to endorse and, in some cases, require firms listed on their stock exchanges to provide information about their sustainability[1] and financial performance in an integrated manner.[2] According to the advocates of the new reporting trend, the adoption of an IR approach is expected to improve the quality of information for providers of financial capital and to promote a more cohesive and efficient approach to corporate reporting by connecting previously disconnected pieces of financial and sustainability information (Cho et al., 2013; Eccles and Saltzman, 2011; Eccles and Serafeim, 2011; Middleton, 2015). Similarly, the International Integrated Reporting Council[3] (hereafter IIRC), in its recently released Framework on IR, explicitly prioritizes the information needs of investors and clearly takes the stance that the adoption of an IR approach improves the usefulness of financial reporting to investors or differently the value relevance of financial information (IIRC, 2013). Nevertheless, whether the relevance of financial information is indeed enhanced by putting financial reporting into a wider, more integrated perspective, while applying the same accounting standards, is an open empirical question (Cheng et al., 2014; de Villiers et al., 2014; Solomon and Maroun, 2012).

Our study aims to enrich understanding on IR by providing empirical evidence on whether the value relevance of summary accounting information (i.e., book value of equity and earnings) of firms listed on the Johannesburg Stock Exchange (hereafter JSE) has enhanced after the mandatory adoption of an IR approach. In 2010, the JSE became the first capital market in the world to require the adoption of an IR approach by its listed firms. That was brought on by JSE's decision to include the then newly released King III Report (hereafter King III) in its listing requirements. King III calls for the integration of information about a firm's financial and sustainability performance (IDSA, 2009). Further, King III, as well as the IIRC Framework, acknowledge the importance of IR for capital market participants and recognize the need to contextualize financial reporting by reporting on how a firm has affected the economic life of its external environment. According to King III, such an approach will lead to reporting that enables an informed assessment of a firm's market value.

IR is a fairly new concept and, even though there are voices that explicitly call for the mandatory adoption of a reporting approach under which financial and sustainability information will be presented in an integrated manner (Cho et al., 2013; Eccles and Serafeim, 2011; Middleton, 2015), there is no empirical evidence on whether investors find integrated reports more decision-useful than traditional annual reports (Cheng et al., 2014; de Villiers et al., 2014; Solomon and Maroun, 2012). This study investigates whether the value relevance of summary accounting information has indeed increased after the mandatory adoption of an IR approach. For our empirical test we utilize a balanced sample of all non-financial and non-utilities firms listed on the JSE during the six-year period of 2008–2013 and employ a linear price-level model which associates a firm's market value of equity

[1] "Sustainability reporting" and "sustainability report" refer to business reporting about environmental, social, governance, and health and safety related issues published by a firm through a separate report or in a distinctive section of its annual report.

[2] Some examples are Malaysia (Bursa Malaysia, 2010), Singapore (Singapore Exchange, 2011), Norway (Norwegian Ministry of Finance, 2014) and the European Union (European Commission, 2014).

[3] The International Integrated Reporting Council (IIRC) can be seen as the flagship of the IR movement where important global players of the economic and business community and policy makers have joined forces in order to develop and promote IR. More information about the IIRC is given in the second section.