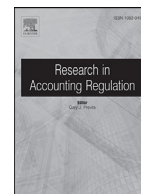




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Research Report

Evolution of corporate reporting: From stand-alone corporate social responsibility reporting to integrated reporting

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ABSTRACT

Both financial and corporate social responsibility (CSR) reporting are bound by global constraints. A common trait among the reporting systems is a growing movement toward comparability and accountability. Global pressures initially motivated the push toward stand-alone CSR reporting and now toward integrated reporting. Integrated reports (IR) include financial, economic, governance, and social information in one report. In the United States, integrated reporting is voluntary and only a small number of companies have issued IRs to date. This report provides a history of CSR reporting and then examines whether the *non-financial* economic, governance and social indicators identified in prior literature as being of interest to retail investors (Cohen et al. 2011) are disclosed in the pioneering U.S. IRs. Descriptive results indicate the initial IRs cover predominately indicators of economic and social performance with little focus on governance. Further analysis indicates that the IRs examined do not, as a rule, provide the information most highly desired by investors (i.e. market share, executive compensation, and product safety). This study provides a baseline for companies preparing IRs and for regulators (i.e. SEC, FASB) in the context of determining future disclosure regulations.

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1. Introduction

While traditional financial statements report information that has financial implications to stakeholders, corporate social responsibility (CSR) reports provide non-financial information regarding governance and social¹ impacts of organizations that have both financial and non-financial implications to stakeholders. Although both financial statements and CSR reports are used to report relevant information, firms increasingly rely on CSR reports to address stakeholders' increasing demands for transparency and accountability, in addition to information relating to a variety of risks and opportunities not evident from traditional reports (KPMG, 2008).

In this paper, the evolution of corporate reporting from financial statements to stand-alone CSR reports to integrated reports (IR) is examined. An IR combines financial, economic, governance, and social information in one report. As stakeholders increasingly make decisions based on a combined understanding of financial and non-financial implications, integrated reporting presentation meets user needs. As the global demand for CSR reporting increases, the costs and risks of *not* reporting both financial and non-financial information will also increase. Therefore, it is likely in the

economic interest of firms to report accordingly. In this study, an examination of the types of non-financial information reported in the front-running U.S. IRs is conducted. As the SEC is currently seeking public comment related to Regulation S-X disclosure requirements, this study provides some initial evidence on the type and usefulness of information disclosed in the front-running U.S. IRs.

Legitimacy theory suggests that firms communicate information to stakeholders in order to conform to societal expectations (Ashforth & Gibbs, 1990). The past focus for firm management to provide historical financial information to external stakeholders has evolved. Though costly to collect and report, it is now a good business practice for firms to provide information on non-financial issues in their organization in order to attract and retain clients and customers. Stakeholders demand transparency, accountability, and strategic information connecting the past to future risks and opportunities (information generally not provided by traditional financial reporting). Shareholders have expressed interest in non-financial performance measures through shareholder resolutions requiring companies to report sustainability information using Global Reporting Initiative (GRI) disclosure guidelines.

In the United States, regulators have weighed in on the importance of non-financial performance measures in the Dodd-Frank Act. Additionally, the JOBS Act passed by U.S. Congress in April of 2012 requires the SEC to examine ways to simplify and modernize disclosure requirements for "emerging growth" companies.

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¹ The term "social" includes reference to both social and environmental issues.

Based on the SEC's disclosure study, the SEC then determined that a disclosure review should be conducted for all SEC registrants and in September 2015, they published a request for public comment on Regulation S-X disclosure requirements (Herz, 2016). In some countries, primarily in Europe, recent legislation mandates specific CSR disclosures (Tschopp & Huefner, 2015). These countries include Denmark (Frost, 2007), France (Husser, Jean-Marc, Barbat, & Lespinet-Najib, 2012; Morris & Baddache, 2012), Norway, and the UK (Tschopp & Huefner, 2015). The Financial Reporting Council in the U.K. also recently issued draft amendments and guidance relating to non-financial disclosures that will be required to be made by certain large companies under the Companies Act 2006 (FRC, 2017).² Thus, evidence exists from shareholders and regulators on the increasing importance for management to not only have, but also provide, CSR information as a basis for making informed strategic decisions.

Prior research provides evidence that enhanced disclosure, and particularly that related to CSR information, is in the economic interest of the firm. Related to disclosure, in general, prior studies provide evidence that enhanced disclosure provides benefits to companies including higher credit ratings (Hefflin, Shaw, & Wild, 2011) and positive capital market reaction to disclosure regulations (Fogel, El-Khatib, Feng, & Torres-Spelliscy, 2015). Studies document that standards eliminating or reducing disclosure deprive capital market of value-relevant information (Bauman, 2013; Chakrabarty & Shaw, 2012; Behn, Riley, Gotti, & Brooks, 2011).

The impact of voluntary disclosures, in general, have been studied in a variety of settings including airline industry deregulation (Gelb, Henry, & Holtzman, 2008), family ownership (Al-Akra & Hutchinson, 2013), and firm-specific case studies (Carduff & Fogerty, 2014; Celik, 2003). As related to the benefits of reporting voluntary CSR information, prior studies show the provision of CSR information is associated with lower firm risk (Orlitzky & Benjamin, 2001; Orlitzky, Schmidt, & Rynes, 2003), lower cost of equity (Dhaliwal, Li, Tsang, & Yang, 2011; Plumlee et al. 2015), lower cost of debt (Bauer & Hann, 2010; Goss & Roberts, 2009), higher credit ratings (Bauer & Hann, 2010), higher stock market performance during times of financial crisis (Lins, Servaes, & Tamayo, 2017), and more optimistic analyst recommendations (Ioannou & Serafein, 2010). Prior literature examines CSR disclosure associations with environmental performance (de Villiers & van Staden, 2011; Ashcroft & Smith, 2008; Ashcroft et al. 2008); governance attributes (Haniffa & Cooke, 2005, Rupley, Brown, & Marshall, 2012); and public shareholders (Cormier & Magnan, 1997, 2003). It should be noted, however, that bias may exist in voluntary reporting for companies to report only successes, or as prior studies suggest, to "window dress" or cover up corporate misconduct (Wang & Tuttle, 2014).

This study builds on existing research in the CSR disclosure area. We extend this research by using a small sample/case method to investigate IR disclosures. Specifically, this study takes reported information about investors' likelihood of using particular non-financial data from a study by Cohen, Holder-Webb, Nath, and Wood (2011) and determines whether the highly rated information is reported in the front-running IRs produced by public U.S. companies. Findings indicate that these front-running IRs do not, as a rule, provide the information most highly rated by investors.

The remainder of the paper is organized as follows. Section 2 discusses the evolution of CSR reporting. Section 3 provides a descriptive discussion of eight U.S. front-running company IRs. The final section concludes with a discussion of the implications for regulators and academics.

2. Evolution of CSR

The beginning of modern voluntary sustainability reporting may reasonably be traced to the Exxon Valdez oil spill and the subsequent call by a coalition of socially responsible investment (SRI) funds and environmental groups for greater disclosure of environmental risks by corporate actors. Social investment professionals formed the Coalition for Environmentally Responsible Economies (CERES) in 1989 soon after the Valdez spill. CERES released a set of ten "principles", called the Valdez Principles, ranging from general environmental concepts to specific disclosures (Feder, 1989).

In 1997, CERES launched the GRI to integrate and unify economic, governance, and CSR reporting standards in the global marketplace into a single sustainability-reporting framework (Gilbert, 2002). CERES viewed the GRI "like the Financial Accounting Standards Board in the U.S. and standard-setting bodies elsewhere in the financial world" with a single but vital mission—to generate consensus among global constituencies regarding which corporate sustainability attributes should be measured and how they should be reported (CERES, 2002: 14). CERES later released its first official framework for sustainability reporting as the 2000 GRI Guidelines.³ Relying on public comments, CERES began an in-depth standards revision process aligning the Guidelines closer with major international sustainability agreements that resulted in the 2002 revised Guidelines. These Guidelines included increasingly specific definitions and indicators and an emphasis on verification and assurance. Institutional investor activism began to focus on shareholder resolutions, generally co-sponsored by a number of asset management firms, requiring corporations, including major multinationals such as Microsoft, IBM and Pepsi, to report according to the GRI guidelines. The GRI issued revised G3 Guidelines in 2006 that eliminated indicators not considered relevant to most stakeholders. The most recent GRI G4 Guidelines, issued in 2013, include the following key revisions: disclosures of performance related to only material issues relevant to the business risks, further consideration given to the supply chain - both upstream and downstream, and additional governance and ethics indicators (Margolis, 2013).

Additional changes in the continually evolving sustainability reporting field include the creation of the Sustainability Accounting Standards Board (SASB) and integrated reporting. The non-profit SASB was launched in 2012 to provide industry-specific sustainability reporting guidance for 79 identified industries among the Securities Exchange Commission (SEC) registrants. Recognizing that "one size does not fit all," the SASB's focus is on material risks and opportunities by industry. Just as the SEC has a history of requiring companies to disclose material risks related to financial information, the SASB identifies a broader range of "sustainability" issues that pose potential financial risk that can only be understood by analysis of non-financial information. SASB's founder and executive director, Jean Rogers, stated the following in regards to a comparison of SASB and the GRI:

"We are designing for a very specific mechanism, which is the Form 10-K. We consider ourselves the floor and GRI more of the ceiling. In other words, we're the minimum set of things that are highly material and would be recognized as such by the SEC."Greenbiz.com October 1, 2012.

SASB standards provide a platform to assess what material disclosures should be made in a company's 10-K. While SASB standards are directed toward SEC reporting, there has also been a move toward reporting a broad set of economic, governance, and

² Disclosures are related to the environment, employees, social matters, respect for human rights, and anti-corruption and anti-bribery matters.

³ The Guidelines quickly gained momentum and within a year one-third of the CSR reports prepared by the world's largest companies acknowledged the GRI Guidelines (Kolk, 2004).

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