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### Regulatory Effectiveness on Auditing and Taxation, Corporate Reporting and Contemporary Issues

Investors' Perception and Audit Expectation-Performance Gap (AEG) in the Context of Listed Firms in Sri Lanka

*J.S. Kumari, Roshan Ajward, D.B.P.H. Dissabandara*

Level and Determinants of Corporate Tax Non-Compliance: Evidence from Tax Experts in Sri Lanka

*Nipuni Senanayake, Isuru Manawadu*

The Impact of Audit Quality on the Degree of Earnings Management: An Empirical Study of Selected Sri Lankan Listed Companies

*Amanda Pakianathan, Roshan Ajward, Samantha Senaratne*

An Assessment of Integrated Performance Reporting: Three Case Studies in Sri Lanka

*Chandrasiri Abeyasinghe*

Is Sustainability Reporting a Business Strategy for Firm's Growth? Empirical Evidence from Sri Lankan Listed Manufacturing Firms

*T.D.S.H. Dissanayake, A.D.M. Dissanayake, Roshan Ajward*

The Impact of Corporate Governance Characteristics on the Forward-Looking Disclosures in Integrated Reports of Bank, Finance and Insurance Sector Companies in Sri Lanka

*Asra Mahir, Roshan Herath, Samantha Senaratne*

Trends in Climate Risk Disclosures in the Insurance Companies of Sri Lanka

*M.N.F. Nuskiya, E.M.A.S.B. Ekanayake*

The Level of Usage and Importance of Fraud Detection and Prevention Techniques Used in Sri Lankan Banking and Finance Institutions: Perceptions of Internal and External Auditors

*D.T. Jayasinghe, Roshan Ajward*

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# **THE IMPACT OF CORPORATE GOVERNANCE CHARACTERISTICS OF THE FORWARD-LOOKING DISCLOSURES IN INTEGRATED REPORTS OF BANK, FINANCE AND INSURANCE SECTOR COMPANIES IN SRI LANKA**

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## **Abstract**

This paper examines the extent of forward looking disclosures (FLD) in integrated reporting (IR) and the impact of corporate governance characteristics on the extent of FLD. This study relates to the Bank, Finance and Insurance (BFI) Sector in Sri Lanka over three consecutive years from 2015 to 2017. This sector has the highest number of companies that have prepared integrated reports among the companies listed on the Colombo Stock Exchange (CSE). The study used structured content analysis based on a disclosure index developed on the International Integrated Reporting Framework (IIRF) to investigate FLDs provided by these companies in integrated reports. The study finds that these companies provide less FLDs in relation to the content elements of IIRF. However, these disclosures have shown an increasing trend over time. This study further show that corporate governance characteristics -board size, board expertise, independence of audit committee, and audit committee meetings- have positively impacted on the extent of FLDs in these companies and board independence is negatively associated with FLDs. At present, there is a dearth of research on FLD practices in IRs in general and particularly in the developing countries. Hence, this research study contributes to the current literature on FLDs in IR in a developing country context. The findings of the study also provides insights for policy makers and practitioners with regard to FLD practices in companies that prepare integrated reports and the need to establish specific guidelines in this respect.

**Key words:** Corporate Governance, Forward-Looking Disclosure, Integrated Reports, Structured Content Analysis.

## **1 INTRODUCTION**

Public listed companies are required to publish Annual Reports consisting of financial statements, that reveal the financial situation of an organization, and corporate governance reports that reveal the level of corporate governance practices (Garcia-Sanchez et al., 2013). However, companies voluntarily publish corporate sustainability, social and environmental reports as a form of non-financial information disclosure to improve the transparency and accountability of disclosures (Oliveira et al., 2010). Though many disclosures are provided, the absence of a single report leads to information confusion and diffusion for stakeholders (Ioana & Adriana 2014). Hence, the provision of a single report combining both financial and non-financial information has been identified as a solution to this issue (Cheng et al., 2014). This led to the introduction of integrated reports by the International Integrated

Reporting Council (IIRC) as distinct reports, which combine both financial and non-financial information focusing on the value creation of a business (IIRC 2013). According to Brown and Dillard (2014), integrated reporting (IR) has become a new reporting paradigm, which provides a comprehensive view of an entity's information that links both financial and non-financial aspects unlike traditional financial reports.

The type of information published in annual corporate reports can be described as 'backward-looking information' or 'forward-looking information' (Hussainey 2004). Backward-looking information consists of past financial records as a form of financial statements and related disclosures (Aljifri & Hussainey 2007). On the other hand, future-oriented, prospective and forecasted information is referred to as forward-looking information (Alkhatib, 2014). All stakeholders including shareholders expect future forecasts because their decisions have to be taken within a dynamic economic environment, and backward-looking historical financial information does not fulfill their requirements sufficiently (Menicucci, 2013). As a result, forward-looking information, comprising future forecasted information on both financial and non-financial disclosures has become more important for all stakeholders (Bravo 2016; Aljifri & Hussainey 2007). Thus, the uncertainty about an entity can be mitigated by the strategic selection of information to be disclosed in corporate reports (Aljifri & Hussainey 2007). However, in spite of companies publishing integrated reports, there is a dearth of studies on the provision of FLDs in IR and the determinants of FLD.

In this context, this paper examines the nature and extent of forward-looking disclosures (FLD) in IR and the impact of corporate governance characteristics on the provision of such information. Hence, the research questions addressed in the study are two-fold: (a) what is the nature and extent of FLD in integrated reports published by companies and (b) do the corporate governance characteristics of companies impact on the level of FLD provided in integrated reports. This study was carried out in the companies listed in the Bank, Finance and Insurance (BFI) Sector of the Colombo Stock Exchange (CSE) during the three-year period from 2015 to 2017.

Theoretically, the study addresses the research gap that exists in the FLDs in integrated reports from a developing country perspective. Practically, the study provides insights for policy makers and practitioners into the nature and extent of FLD in integrated reports and the implications of governance practices of companies on the extent of FLD in IR.

The rest of the paper is organized as follows: Section two reviews the existing literature, and Section three discusses the methodology of the study. Section four analyses and discusses the research findings. Finally, Section five presents the conclusions of the study.

## **2 LITERATURE REVIEW**

This section reviews the prior literature dealing with the main themes of the study.

### **2.1 Forward-Looking Disclosures (FLDs)**

The current literature examines the factors that have influenced FLDs using the signaling theory (Spence 1973) and agency theory (Jensen & Meckling 1976). The two theories are closely related to the determinants of the level of FLDs (Elzahar & Hussainey 2012). The agency theory explains the relationship between the shareholders (principals) and the

managers (agents). Shareholders delegate responsibilities to professional managers, who understand the business and manage the assets of the company in order to fulfill their objectives (Jensen & Meckling 1976). However, this has led to information asymmetry between shareholders and managers, as the latter have access to all company specific internal information, which the former does not have. The agency theory further explains that voluntary disclosures can be used as a mechanism to mitigate information asymmetry and provide more future-oriented information to reduce agency costs (Hassanein & Hussainey 2015). Therefore, most public listed companies tend to publish FLDs in their annual reports to reduce information asymmetry and agency costs in order to attract and retain investors in the organization.

The other theoretical basis behind the determinants of the level of FLD is the signaling theory. It explains the uncertainty and risks associated with the labour market. From the perspective of signaling theory, the disclosure of future forecasted information acts as a signal to the capital market. According to this theory, FLD performs the role of mitigating information asymmetry and reducing unnecessary costs incurred in improving corporate value (Gallego-Álvarez et al., 2011). The signaling theory proposes that managers should try to enhance the level of disclosures of company-specific information in their annual reports to provide signals to their potential investors and other users (Elzahar & Hussainey 2012).

Prior studies have found that organizations tend to provide FLDs as qualitative information rather than quantitative information (Kent & Ung 2003). This is to avoid the possible litigation costs that could arise from the provision of wrong future predictions and negative impacts that it could cause on a company's competitive position (Clarkson et al., 1994). There are a number of studies that attempt to explain what motivates companies to voluntarily disclose additional information. In this respect, Healy and Palepu (2001) and Walker (1997) provide comprehensive reviews in the literature.

However, different views have been presented in prior studies on the disclosure of FLDs in annual reports. In this respect, Kieso and Weygandt (1995) argue that the lack of FLD can lead investors to make their forecasts based on inaccurate information from other sources. They also argue that the economic environment is too turbulent to rely solely on historical information. Some studies have argued that information asymmetry between stakeholders and managers will be mitigated by the provision of FLDs in published annual reports, which in turn reduce the external financing cost of companies (Bujaki et al., 1999). These arguments provide an impetus for the voluntary disclosure of capital market transactions (Healy & Palepu 2001).

On the other hand, some researchers refer to the negative implications of the provision of FLDs. It has been argued that due to the uncertainty associated with the future, it is difficult to make accurate predictions. In addition, companies can be leveraged by their reaction to the level of their forecasts (Kasznik 1999). Companies also show a reluctance to disclose FLDs due to the possible litigation costs in relation to predictions (Uyar & Kilic, 2012) owing to the inability of the legal system to distinguish between uncertainty and error caused by forecasting. FLDs could also negatively impact on the competitive position of companies as per the proprietary cost hypothesis (Healy & Palepu, 2001; Uyar & Kilic, 2012).

The findings and arguments put forward in prior studies highlight that the provision of FLDs have become an important discussion point in the annual reports of companies. The next section considers this dimension in the context of IR.

## **2.2 Integrated Reporting**

Integrated reporting (IR) entails a new and innovative approach to current corporate reporting practice. It is now increasingly used in many countries in accordance with the International Integrated Reporting Framework (IIRF) issued by the International Integrated Reporting Council (IIRC). This has resulted in developing integrated reports to overcome the problem of providing information in different strands of reporting (Gray, 2010; IRCSA 2011). According to IIRC (2013), the integrated report, the output of IR, provides concise communication about how an organization's strategy, governance, performance and prospects, in the context of its external environment, leads to the creation of value in the short, medium and long term.

IIRC recommends that financial and non-financial information should not be presented as isolated reports but as a single report reflecting an integrated approach comprising both financial and non-financial information to ensure sustainable returns by managing various types of capital such as financial, manufactured, intellectual, social/relationship, human and natural (Solomon & Maroun 2012; IIRC 2013). Considering the interconnections between these different types of 'stock of capital' (IIRC para. 2.11), the strategies and the business model should be clearly communicated among all stakeholders allowing them to influence and make changes to the operations, systems, processes and procedures of the organization, which ensure an enhancement of the sustainable growth in the long run (Adams et al., 2016; de Villiers et al., 2016).

IIRF has introduced a set of guiding principles and content elements to guide those preparing corporate report to ensure effective IR practices (IIRC 2013). In comparison with conventional financial statements, integrated reports are more forward-looking, stakeholder-oriented, and framed in accordance with strategic objectives and the business model of organizations. It is required to provide an explanation of the economic, social and environmental variables, which incorporate the risk affecting the sustainability of the business model (Stubbs & Higgins, 2014; Raemaekers et al., 2016). This approach enables an entity to provide both positive and negative information to the stakeholders, which is accurate, relevant, reliable and material and free from any misleading and ambiguous facts (IIRC 2013). This is founded upon a well-established corporate governance system. Campbell (2006) states that when there are coercive and normative pressures from a well-established and governed legal system, companies would ensure stakeholder protection, act responsibly and be accountable for their behavior.

The empirical studies on IR indicate the importance of FLD in integrated reports and the extent to which such disclosures are impacted by several factors. Among these factors, corporate governance is recognized as an important variable, as discussed in the next section.

## **2.3 Corporate Governance**

Corporate governance (CG) is "the system by which companies are directed and controlled" (Cadbury, 1992, p.14). There is a high probability of voluntary provision of FLD from the firms, which have a significant adoption of corporate governance practices (Hossain et al., 2005; Karamanou & Vafeas 2005). Thus, many studies have investigated the relationship between corporate governance characteristics and the level of FLD (O' Sullivan et al., 2008).

Aljifri & Hussainey (2007), who investigated the determinants of FLD in annual reports of companies in the United Arab Emirates, find that profitability, debt ratio, auditor size, sector type and the firm size have a significant impact on the level of FLD. Further, Akhtaruddin et al., (2009) report that voluntary disclosures are positively associated with board size and the proportion of independent non-executive directors on the board, and the family control and the ratio of audit committee members to the number of board members are negatively related with the disclosure of voluntary information.

Furthermore, Kent and Ung (2003) investigated the impact of external financing, competition, earnings volatility, auditor quality and firm size as control variables on FLD of Australian firms. The firm finds that only earning volatility and firm size have a significant influence on FLD. Most studies have identified board size, proportion of independent non-executive directors and firm size as the determining factors of FLD (Alkhatib 2014, Uyar & Kilic, 2012, Kılıç & Kuzey, 2018, Abeywardana & Panditharathna, 2016).

Further, several prior studies (Abed, 2014, Uyar & Kilic, 2012; Aljifri & Hussainey, 2007) identify board size, board independence, board gender diversity, board expertise, board meetings, audit committee size, independence of audit committee, expertise in audit committee and number of audit committee meetings as the corporate governance variables that have a high impact on the provision of FLD.

The methodology used in the study in the context of the extant literature is discussed next.

### **3 RESEARCH METHODOLOGY**

This section outlines the research approach, the selected sample, the data collected, the conceptual framework and operationalization of the variables and analytical strategies of the study.

#### **3.1 Research Approach**

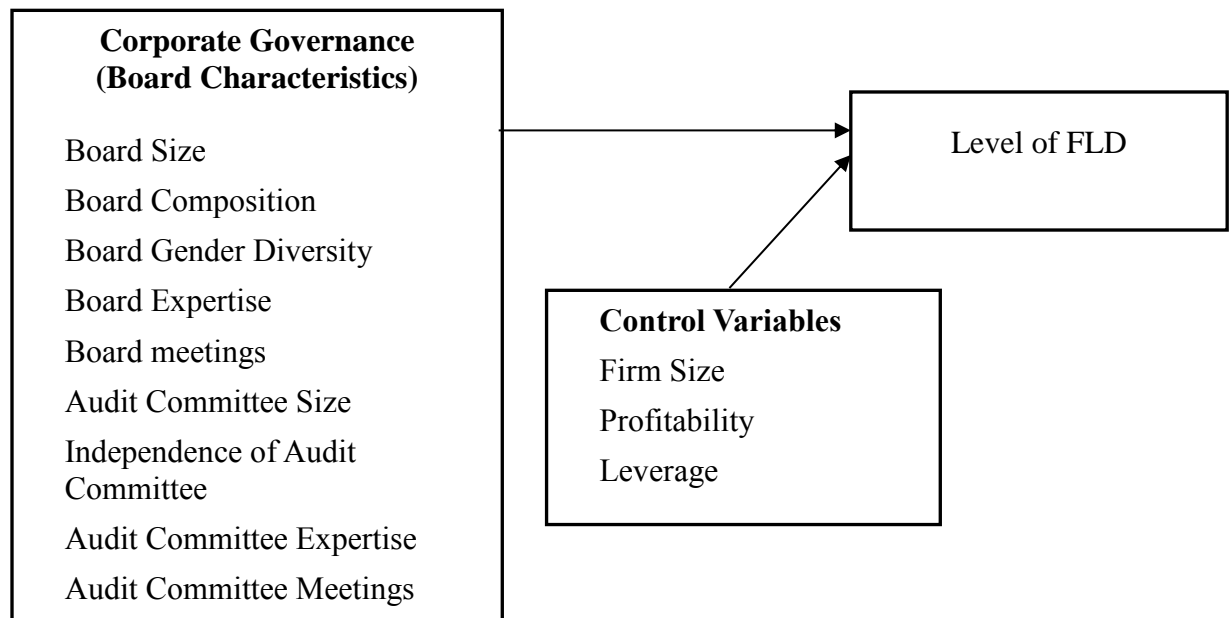
The quantitative approach has been followed since this study investigates the relationship between the selected corporate governance characteristics and the level of FLD. Furthermore, most prior research studies (Al-Najjar & Abed 2014, Uyar & Kilic2012, Aljifri & Hussainey2007) have adopted a similar quantitative approach to investigate the relationship between the corporate governance characteristics and the level of FLD.

#### **3.2 Population and Sample**

The population and sample of the study are the same as all 22 companies of BFI Sector (Refer Annexure 01) that prepare integrated reports for three consecutive years from 2015 to 2017 have been selected.

### 3.3 Conceptual Framework and Hypotheses of the Study

Figure 1 presents the conceptual framework of the study based on the literature review. It depicts the expected relationship between the selected corporate governance characteristics and the level of FLD.



**Figure 1: Conceptual Diagram**

Source: Constructed by Authors

### 3.4 Hypotheses

Based on the conceptual framework of the study, the following hypotheses were derived.

- H<sub>1</sub>: There is a positive association between board size and the level of forward-looking disclosures.
- H<sub>2</sub>: There is a positive association between board independence and the level of forward-looking disclosures.
- H<sub>3</sub>: There is a positive association between board gender diversity and the level of forward-looking disclosures.
- H<sub>4</sub>: There is a positive association between board expertise and the level of forward-looking disclosures.
- H<sub>5</sub>: There is a positive association between board meetings and the level of forward-looking disclosures.
- H<sub>6</sub>: There is a positive association between audit committee size and the level of forward-looking disclosures.
- H<sub>7</sub>: There is a positive association between the independence of the audit committee and the level of forward-looking disclosures.
- H<sub>8</sub>: There is a positive association between the expertise in the audit committee and the level of forward-looking disclosures.
- H<sub>9</sub>: There is a positive association between audit committee meetings and the level of forward-looking disclosures.

### 3.5 Operationalization

Table 1 presents the operationalization of the dependent, independent and control variables.

**Table 1: Operationalization of Variables**

| Concept                      | Variable                                | Working Definition  | Measurement  | Related Studies                      |
|------------------------------|---|---|--|--------------------------------------|
| <b>Dependent Variables</b>   |   |   |  |                                      |
| Forward-looking disclosure   | Total forward-looking disclosure (FLDI) | Forward-looking information can be classified as qualitative and quantitative for firm <i>i</i> and period <i>t</i> .   | The proportion of disclosed items to the total items in the index for firm <i>i</i> period <i>t</i> .                  | Menicucci and Paolucci (2017)        |
| <b>Independent Variables</b> |   |   |  |                                      |
| Corporate Governance         | Board size (BSIZE)                      | Total number of executive and non-executive board members in the board of directors consider as the board size.   | Total number of directors of the board of the firm <i>i</i> period <i>t</i> .  | Muchemwa, Padia and Callaghan (2016) |
|                              | Board composition (BINDP)               | The total independent directors as a percentage of total number of directors in the board.  | The proportion of non-executive directors to total number of directors in the board in firm <i>i</i> period <i>t</i> . | Oconnel and Cramer (2010)            |
|                              | Board gender diversity (GENDIV)         | The differentiation between board members in terms of several characteristics such as gender, ethnicity, age, behaviors, educational qualifications, learning styles, expertise knowledge and skills. Here it is considered in terms of gender. | The proportion of female directors to total number of directors in the board in firm <i>i</i> period <i>t</i> .        | Erhardt, Werbel and Shrader(2003)    |



|                          |                                       |  |   |                                 |
|--------------------------|---------------------------------------|--|---|---------------------------------|
|                          | Board Expertise (BEXP)                | Number of members with financial or/and accounting qualifications for firm <i>i</i> and period <i>t</i> .                      | The proportion of board expertise to total number of directors in the board in firm <i>i</i> period <i>t</i> .                    | Ujunwa (2012)                   |
|                          | Board Meetings (BODM)                 | Number of board meetings held during the period <i>t</i> of the firm <i>i</i>  | No. of board meetings held during the period in firm <i>i</i> period <i>t</i> .   | Hoque, Islam and Azam (2013)    |
|                          | Audit Committee size (AUDCSIZE)       | Number of members in the audit committee for firm <i>i</i> and period <i>t</i> .   | Number of audit committee members for firm <i>i</i> period <i>t</i> .   | Xie, Davidson and DaDalt (2003) |
|                          | Audit Committee Independence (INDPAC) | Number of independent non- executive directors on the Audit Committee for firm <i>i</i> and period <i>t</i> .                  | The proportion of non- executive directors to total number of directors in the audit committee in firm <i>i</i> period <i>t</i> . | Klein (2002)                    |
|                          | Audit Committee Expertise (AUDCEXP)   | Number of members with Finance or/and Accounting qualifications in the audit committee for firm <i>i</i> and period <i>t</i> . | The proportion of board expertise to total number of directors in the audit committee for firm <i>i</i> period <i>t</i> .         | Abbott et al. 2004              |
|                          | Audit Committee Meetings (AUDCM)      | Number of audit committee meetings held during the period <i>t</i> of the firm <i>i</i>  | No. of audit committee meetings held during the period for firm <i>i</i> period <i>t</i> .  | Davidson and DaDalt (2003)      |
| <b>Control Variables</b> |                                       |  |   |                                 |
|                          | Firm size (FSIZE)                     | Firm Size is the size of a particular firm in terms of total assets for a particular period.                                   | The natural logarithm of total assets at the beginning of the year for firm <i>i</i> period <i>t</i> .                            | Hidayat and Utma (2016)         |
|                          | Return on assets (ROA)                | The net income earnings for the  | Net Income / Total Assets (t-1)   | Hidayat and Utma (2016)         |

|  |                |  |  |                          |
|--|----------------|--|--|--------------------------|
|  |                | current period as a percentage of total assets utilized.                               |  |                          |
|  | Leverage (LEV) | Leverage is the total liabilities scaled by total assets at the beginning of the year. | Total liabilities (t-1) / Total Assets (t-1) | Oconnel and Cramer(2010) |

Source: Constructed by Authors

To identify the nature and extent of FLDs in the integrated reports of sample companies, a FLD index (Refer Appendix 2) was adopted based on the study of Menicucci and Paolucci (2017). Accordingly, the FLD index covers six content elements of IIRF - Organizational Overview and External Environment (ORG), Governance (GOV), Business Model (BUS), Risks and Opportunities (RISK), Strategy and Resource Allocation (STR), and Performance (PERF), ignoring two content elements because ‘Outlook’ element by its nature reflects future information and ‘Basis of Preparation’ always represents historical data. Under these six areas, 27 information categories were identified. The integrated reports of sample companies were evaluated under each category by counting the related sentences on FLD. Thereafter, an FLD score for each content element of the index was calculated for sample companies for the three consecutive years based on the natural logarithm of the sentence count.

### 3.6 Analytical Strategies

In the examination of the first objective of the study (assessing the nature and extent of FLD), descriptive statistics including measures of central tendencies and dispersions were calculated. In the achievement of the second objective (examining the relationship between corporate governance characteristics and level of FLD), correlation, multivariate linear regression and panel regression analyses (including the Hausman test for identification of random and fixed effects) were done. Further, regression diagnostics such as normality, linearity, heteroscedasticity and multicollinearity analyses were performed. The regression model used in the study is as follows:

#### Research Model

$$\begin{aligned}
 FLDI = & \beta_0 + \beta_1 BSIZE + \beta_2 BINDP + \beta_3 GENDIV + \beta_4 BEXP + \beta_5 BODM \\
 & + \beta_6 AUDCSIZE + \beta_7 INDPAC + \beta_8 AUDCEXP + \beta_9 AUDCM + \beta_{10} FSIZE \\
 & + \beta_{11} ROA + \beta_{12} LEV + \varepsilon
 \end{aligned}$$

The next section provides the findings and discussion of the study.

## 4 FINDINGS AND DISCUSSION

This section presents the findings of the study and the resulting discussion.

### 4.1 Descriptive Statistics

The descriptive statistics of FLD presented in Table 2 indicate that the mean score of all content elements is fairly low indicating a low level of FLD in integrated reports. Of the six content elements of the FLD index, the highest level of FLD was witnessed under ‘Risks and Opportunities’. However, its standard deviation was the second highest, indicating a greater degree of variability of FLD scores of individual companies. This was followed by content elements – ‘Performance’, ‘Strategy and Resource Allocation’, ‘Organizational Overview and External Environment’ and ‘Governance’ in terms of mean scores. The highest standard deviation was reported for “Strategy and Resource Allocation”, which indicates a higher degree of variability of individual company scores. The mean score of FLD of the ‘Business Model’ was the lowest among the six content elements but with a low standard deviation, which indicates that all companies have not provided much FLD in this respect. The peculiar characteristic is that in the case of all content variables, the reported minimum score is 0, which indicates that some companies have not provided any FLD.

The descriptive statistics of corporate governance characteristics are presented in Table 3. The mean value of BSIZE indicates that on average that there are nine directors on the boards of BFI Sector companies that prepare integrated reports. The mean value of board commission 0.820 (82%) indicates that the majority of directors of boards of these companies are represented by independent non-executive directors, which is much higher than in Kilic & Kuzey (2018), where the independent non-executive directors is 59%. The mean value of gender diversity is 14.71%, which indicates less participation of female directors on the boards. The board comprised on average 4 to 5 directors with accounting and finance expertise and on average 14 board meetings were held during the period under consideration. It is important to note that the standard deviation of board meetings was comparatively high compared to the relatively low scores for the same for other variables.

The descriptive statistics on the characteristics of the audit committee provided in Table 3 presents that on average 3 to 4 directors (AUDCSIZE) were present in the audit committee of these companies with on average two directors with accounting and financial proficiency (AUDCEXP) on the audit committee. Further, on average 9 meetings of audit committee (AUDCM) have been held in these companies during this period. However, its standard deviation was comparatively higher when considering the low scores of the same for other variables.

The mean values of firm size (natural logarithm) and ROA are 8.91 and 0.049 respectively. The mean score of leverage of IR adopters is measured through the ratio of total liabilities to total assets which is 0.85 indicating the fact that the assets of these companies are financed mainly through the deposits of customers.

**Table 2: Descriptive Statistics of Level of FLD**

| <b>FLD Disclosure Criteria<sup>a</sup></b>             | <b>N</b> | <b>Mean</b> | <b>Mean%</b> | <b>Std. Deviation</b> | <b>Minimum</b> | <b>Maximum</b> |
|--|----------|-------------|--------------|-----------------------|----------------|----------------|
| Organizational Overview and External Environment (ORG) | 66       | 2.2424      | 10.83        | 2.2740                | 0.0000         | 14.0000        |
| Governance (GOV) Business Model (BUS)                  | 66       | 1.9848      | 9.59         | 1.7051                | 0.0000         | 9.0000         |
| Risks and Opportunities (RISK)                         | 66       | 1.3030      | 6.30         | 1.6452                | 0.0000         | 8.0000         |
| Strategy and Resource Allocation (STR)                 | 66       | 5.4848      | 26.50        | 3.6342                | 0.0000         | 18.0000        |
| Performance (PERF)                                     | 66       | 4.8030      | 23.21        | 3.8279                | 0.0000         | 18.0000        |
| Forward-looking Disclosure Index (FLDI) <sup>b</sup>   | 66       | 4.8787      | 23.57        | 2.9898                | 0.0000         | 13.0000        |
|  | 66       | 1.2434      | 100          | 0.2551                | 0.0000         | 1.6720         |

\*See Annexure 3 for the sub-criteria for the main dimensions of FLDI included.

<sup>b</sup> These variables were winsorized at 5% due to the presence of outliers.

Source: Constructed by Authors

**Table 3: Descriptive Statistics of Corporate Governance Characteristics and Control Variables**

| <b>Variable<sup>a</sup></b>                        | <b>N</b> | <b>Mean</b> | <b>Std. Deviation</b> | <b>Minimum</b> | <b>Maximum</b> |
|--|----------|-------------|-----------------------|----------------|----------------|
| Board Size (BSIZE)                                 | 66       | 9.318       | 2.185                 | 4.000          | 13.000         |
| Board Composition (BINDP) <sup>b</sup>             | 66       | 0.820       | 0.170                 | 0.500          | 1.000          |
| Board Gender Diversity (GENDIV)                    | 66       | 0.147       | 0.123                 | 0.000          | 0.444          |
| Board Expertise (BEXP)                             | 66       | 4.773       | 1.787                 | 3.000          | 9.000          |
| Board Meetings (BODM) <sup>b</sup>                 | 66       | 13.909      | 3.937                 | 6.000          | 22.000         |
| Audit Committee Size (AUDCSIZE) <sup>b</sup>       | 66       | 3.530       | 0.915                 | 2.000          | 5.000          |
| Audit Committee Independence (INDPAC) <sup>b</sup> | 66       | 2.712       | 0.799                 | 2.000          | 4.000          |
| Audit Committee Expertise (AUDCEXP)                | 66       | 2.318       | 1.025                 | 1.000          | 4.000          |
| Audit Committee Meetings (AUDCM)                   | 66       | 9.455       | 4.084                 | 0.000          | 19.000         |
| Firm Size (FSIZE)                                  | 66       | 8.913       | 1.312                 | 6.758          | 10.851         |
| Profitability (ROA) <sup>b</sup>                   | 66       | 0.039       | 0.049                 | 0.006          | 0.207          |
| Leverage (LEV) <sup>b</sup>                        | 66       | 0.851       | 0.079                 | 0.661          | 0.928          |

<sup>a</sup> Definitions of the variables are indicated in Table 1.

<sup>b</sup> These variables were winsorized at 5% due to the presence of outliers.

Source: Constructed by Authors

**Table 4: Correlation Analysis**

| Variables <sup>a</sup> | FLDI     | BFSIZE  | BINDP   | GENDIV  | BEXP    | BODM     | AUDCSIZE | INDPAC  | AUDCEXP | AUDCM   | FSIZE    | ROA   |
|------------------------|----------|---------|---------|---------|---------|----------|----------|---------|---------|---------|----------|-------|
| BFSIZE                 | .196**   |         |         |         |         |          |          |         |         |         |          |       |
| BINDP                  | -.165**  | .024    |         |         |         |          |          |         |         |         |          |       |
| GENDIV                 | .081     | .431*** | -.137   |         |         |          |          |         |         |         |          |       |
| BEXP                   | .191**   | .637*** | .103    | .067    |         |          |          |         |         |         |          |       |
| BODM                   | -.297**  | .023    | .127    | .025    | -.120   |          |          |         |         |         |          |       |
| AUDCSIZE               | .141     | .472*** | .429*** | .058    | .229    | .132     |          |         |         |         |          |       |
| INDPAC                 | .356***  | .272**  | .163    | .042    | .071    | .108     | .700***  |         |         |         |          |       |
| AUDCEXP                | .153     | .545*** | .170    | .149    | .586*** | -.282**  | .610***  | .389*** |         |         |          |       |
| AUDCM                  | -.260**  | .196    | -.172   | .347*** | .149    | .316***  | -.061    | .068    | .108    |         |          |       |
| FSIZE                  | -.329*** | -.040   | -.274** | -.156   | .087    | .242**   | -.232*   | -.117   | -.024   | .291**  |          |       |
| ROA                    | .132*    | -.151   | .127    | .273**  | .024    | -.315*** | -.169    | -.158   | -.078   | -.256** | -.332*** |       |
| LEV                    | -.161*   | .212    | -.121   | .194    | .108    | .183     | .032     | .218*   | .199*   | .488*** | .253**   | -.240 |

<sup>a</sup> See Table 1 for the definitions of the variables.

\*  $p < 0.1$  \*\*  $p < 0.05$ ; \*\*\*  $p < 0.01$

Source: Constructed by Authors

## **4.2 Relationship between FLD and Corporate Governance Variables**

### **4.2.1 Correlation Analysis**

Table 4 depicts the results of Pearson's bivariate correlation, which indicates that corporate governance characteristics have a significant systematic relationship with the level of FLD. This analysis indicates that board size, board expertise and independence of the audit committee have a significant positive relationship with the level of FLD at a significance level ( $p < 0.05$ ). On the other hand, board independence, the number of board meetings and of audit committee meetings show a significant negative relationship with the level of FLD (at least, at a  $p < 0.05$  level). The results confirm that no collinearity problem exists between the independent variables since multicollinearity can be considered a problem only when the correlation coefficients are above 0.80 (Kennedy, 2008). Furthermore, the size and expertise of the audit committee show no significant systematic relationship between the level of FLD at any of the significance levels ( $p > 0.05$ )

### **4.2.2 Linear Regression**

Table 5 represents the multivariate OLS regression analysis of the FLD determinants of integrated report providers of the BFI sector. The  $R^2$  value indicates that 45.6 per cent of the variation of the level of FLD could be explained using the selected corporate governance mechanisms. Further, the significance of the F-test is below 1% (0.07%), which signifies that the overall model is valid.

The evaluated outcomes shown in Table 5 indicate a positive association between the level of FLD and the corporate governance characteristics -size of board of directors and board expertise. This analysis shows that the board characteristics other than gender diversity and board meetings show a significant relationship with the level of FLD. Among these, a systematic significant ( $p < 0.01$ ) positive relationship is observed only between the size of board of directors and board expertise, and the level of FLD. When considering the audit committee characteristics, the independence of the audit committee and audit committee meetings are significantly positively associated with FLD ( $p < 0.01$  and  $p < 0.05$ ). Other audit committee variables display no significant association with the level of FLD. All three control variables show a significant association with the level of FLD.

Based on this linear regression analysis, it is found that board size, board expertise, independence of audit committee, and audit committee meetings have shown a systematic positive association with the level of FLD. Hence, the results indicate that Hypotheses 1, 4, 7 and 9 of the study are accepted and that these findings are consistent with a number of prior studies (Aljifri & Hussainey 2007, Abed et al., 2011). Further, firm size depicts a significant positive impact on the level of FLD.

**Table 5: Linear Regression Analysis**

| Variables <sup>a</sup> | Coef.    | t      | Collinearity Statistics |       |
|------------------------|----------|--------|-------------------------|-------|
|                        |          |        | Tolerance               | VIF   |
| Constant               | 3.320    | 872.18 |                         |       |
| BFSIZE                 | 0.008*** | 2.73   | .267                    | 3.744 |
| BINDP                  | -0.003** | -2.11  | .624                    | 1.601 |
| GENDIV                 | 0.002    | 0.7    | .411                    | 2.431 |
| BEXP                   | 0.000**  | 1.72   | .320                    | 3.127 |
| BODM                   | 0.000    | -0.78  | .482                    | 2.074 |
| AUDCSIZE               | -0.001   | -0.98  | .179                    | 5.592 |
| INDPAC                 | 0.001*** | 3.07   | .424                    | 2.360 |
| AUDCEXP                | 0.000    | -0.44  | .252                    | 3.967 |
| AUDCM                  | 0.000**  | -2     | .519                    | 1.926 |
| FSIZE                  | 0.000*** | -2.29  | .645                    | 1.549 |
| ROA                    | 0.008*   | 1.34   | .519                    | 1.928 |
| LEV                    | -0.004*  | -1     | .642                    | 1.557 |
| F- Value               |          | 3.56   |                         |       |
| Sig. of F- value       |          | 0.0007 |                         |       |
| R <sup>2</sup>         |          | 0.4561 |                         |       |
| N                      |          | 66     |                         |       |

<sup>a</sup> These variables are defined in Table 1

\* $p < 0.1$  \*\* $p < 0.05$ ; \*\*\* $p < 0.01$

Source: Constructed by Authors

### 4.2.3 Panel Regression

The panel regression outcomes presented in Table 6 are consistent with the results of both the correlation analysis and the linear regression<sup>7</sup> analysis. Table 6 indicates that board size and board expertise depict a significant ( $p < 0.05$ ) positive association with the level of FLD. On the other hand, the independence of the board represents a significant ( $p < 0.05$ ) but negative association with the level of FLD. Further, the independence of the audit committee and audit committee meetings show a significant ( $p < 0.01$ ) positive relationship with the level of FLD. However, all other corporate governance characteristics are not systematically related with the level of FLD. Additionally, firm size represents a significant ( $p < 0.01$ ) positive relationship with FLD.

These findings are consistent with the results of Elzahar and Hussainey (2012), Uyar and Kilic (2012) and Al-Najjar and Abed (2014), who also failed to find a significant effect of board independence on the level of FLD. This insignificant association could result from the effectiveness of independent directors being dependent on the institutional systems and business cultures in which a company operates (Kakabadse et al., 2010).

<sup>7</sup>Fixed effect model was used based on the Hausman test

**Table 6: Panel Regression Analysis**

| Variables             | Co efficient | Z      |
|-----------------------|--------------|--------|
| BSIZE                 | 0.000***     | 0.23   |
| BINDP                 | -0.003***    | -2.09  |
| GENDIV                | 0.002        | 0.87   |
| BEXP                  | 0.000**      | 1.77   |
| BODM                  | 0.000        | -0.94  |
| AUDCSIZE              | -0.001       | -1.05  |
| INDPAC                | 0.001***     | 3.28   |
| AUDCEXP               | 0.000        | -0.45  |
| AUDCM                 | 0.000**      | -2.17  |
| FSIZE                 | 0.000***     | -2.23  |
| ROA                   | 0.003*       | -0.46  |
| LEV                   | -0.004*      | -1.17  |
| Constant              | 3.321        | 898.98 |
| <i>Prob &gt; chi2</i> | 0.000        |        |
| <i>R</i> <sup>2</sup> | 0.4552       |        |
| <i>N</i>              | 22           |        |

<sup>a</sup>Definitions of these variables are indicated under Table 1.

\**p*<0.10; \*\**p*<0.05; \*\*\**p*<0.01

Source: Constructed by Authors

Based on these findings, the conclusions made are presented in the next section.

## 5 SUMMARY & CONCLUSION

This study examined the nature and extent of FLD in integrated reports of BFI Sector companies and the effect of corporate governance characteristics on the level of FLD reported by these companies during the period 2015 to 2017. The study examined the extent of FLDs in integrated reports using a disclosure index developed based on prior literature on the subject. Thereafter, the relationship between the corporate governance characteristics and the level of FLD in integrated reports was examined using correlation and regression (both OLS and panel) analyses. In these analyses, the corporate governance characteristics considered were board size, board independence, board gender diversity, board expertise, board meetings, size of audit committee, audit committee independence, expertise in audit committee and audit committee meetings. The study considered firm size, ROA and leverage as the control variables.

The study finds that most FLDs are limited and qualitative in nature and most disclosures relate to the ‘Risks and Opportunities’ of these companies. On the other hand, the least amount of FLD is witnessed in relation to the business model. Further, the FLD relating to ‘Organization Overview and External Environment and Governance’ is also limited. The study also finds that the degree of FLD fluctuates significantly among the companies that produce integrated reports in this sector.

It was found in the study that board size, board expertise, independence of the audit committee, audit committee meetings and size of the firm have a positive and significant effect on the degree of FLD. On the other hand, board independence has a significant but negative impact on the degree of FLD. This indicates that some corporate governance characteristics play a significant role in the provision of FLD in integrated reports.



The findings of the study have several important implications. Theoretically, the study extends the discussion as to the nature and extent of FLD in integrated reports and show how corporate governance variables impact on FLD in a developing country context – Sri Lanka. Practically, this study shows policy makers and practitioners the types and degree of FLD provided in integrated reports. As there are no specific guidelines as to the disclosure of FLD in IR, policy makers can draw insights to develop a framework or guidance to facilitate the companies in this respect. In the absence of any established guidelines or rules related to the provision of FLD, the disclosures relating to forward-looking statements, profit targets and risk exposure are solely determined by the management of an organization as for their preferences (O’Sullivan et al., 2008). Further, due to the flexibility, type and the nature of the forward-looking information published in the annual reports, it is difficult to provide an assurance as to these disclosures, which in turn leads investors and financial analysts to rely on unregulated and unaudited [foretasted?] information in their decision making process (Schleicher & Walker, 2010). In this context, practitioners can identify how the companies have responded to the need to provide FLD in integrated reports and the improvements required in this respect.

This study has several limitations. Firstly it selected a few but prominent corporate governance characteristics to assess the impact of corporate governance on the level of FLD. However, these characteristics can be extended further in future studies in assessing the relationship between corporate governance and the level of FLD. Secondly, the study focused only on one sector of CSE. This study can be extended to cover a larger sample of companies in future studies.

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## Appendices

### Appendix 1: Sample

22 Bank Finance and Insurance sector companies that have published integrated reports continuously during the period 2015-2017:

- Commercial Bank
- DFCC Bank PLC
- Hatton National Bank PLC
- Housing Development Finance Corporation Bank of Sri Lanka
- National Development Bank PLC
- Nations Trust Bank PLC
- Sampath Bank PLC
- Sanasa Development Bank PLC
- Seylan Bank PLC
- Union Bank Of Colombo PLC
- Alliance Finance Company PLC
- Arpico Finance Company PLC
- Citizens Development Business Finance PLC
- LB Finance PLC
- Mercantile Investments and Finance PLC
- Merchant Bank of Sri Lanka & Finance PLC
- People's Leasing & Finance PLC
- Softlogic Finance PLC
- HNB Assurance PLC
- People's Insurance PLC
- Softlogic Life Insurance PLC
- Union Assurance PLC

## Appendix 2: Items of FLD Index

| Categories of information                              |  |
|--|--|
| Organizational overview and external environment (ORG) | 1. The organization's culture, ethics and values   |
|  | 2. The organization's ownership and operating structure  |
|  | 3. The organization's principal activities and markets   |
|  | 4. The organization's competitive landscape and market positioning   |
|  | 5. The organization's position within the value chain  |
|  | 6. Significant factors affecting the external environment and the organization's response  |
| Governance (GOV)                                       | 7. The organization's leadership structure including skills and diversity  |
|  | 8. Specific processes used to make strategic decisions and to establish and monitor the culture of the organization                                    |
|  | 9. Particular actions charged with governance to influence and monitor the strategic direction of the organization and its approach to risk management |
|  | 10. The relationship between culture, ethics and values of key stakeholders and capital  |
|  | 11. Remuneration and incentives  |
| Business model (BUS)                                   | 12. Key inputs   |
|  | 13. Key business activities  |
|  | 14. Key outputs  |
|  | 15. Key outcomes   |
| Risks and opportunities (RISK)                         | 16. Specific external source of risks and opportunities  |
|  | 17. Specific internal source of risks and opportunities  |
|  | 18. The organization's assessment of the likelihood that a risk or opportunity will come to fruition and the magnitude of its effect if it does        |
|  | 19. The specific steps being taken to mitigate or manage key risks or to create value from key opportunities   |
| Strategy and resource allocation (STR)                 | 20. The organization's short, medium and long term strategic objectives  |
|  | 21. The strategies to achieve strategic objectives   |
|  | 22. The resource allocation plans to implement the strategy  |
|  | 23. The linkage between the organization's strategy and resource allocation plans  |
|  | 24. What differentiates the organization to give it competitive advantage and enable it to create value  |
| Performance (PERF)                                     | 25. The organization's effects on the capitals   |
|  | 26. The state of key stakeholder relationship and how the organization responds to key stakeholder's legitimate needs and interests                    |
|  | 27. The linkage between current performance and the organization's outlook   |

Source: Menicucci and Paolucci (2017)