

Challenges of, and Techniques for, Materiality Determination of Non-Financial Information used by Integrated Report Preparers

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Abstract

Purpose – The International Integrated Reporting Framework (IIRF) encourages organisations to disclose material information that affects their ability to create value. This paper investigates the challenges and techniques preparers of integrated reports employ to determine the materiality of non-financial information.

Design/methodology/Approach – This paper uses an exploratory interpretive thematic analysis and an archival research approach. Qualitative semi-structured interviews were conducted with 55 integrated reporting (IR) preparers in 12 publicly listed companies, supported by the perusal of the companies' integrated annual reports over a three-year period.

Findings – IR preparers find materiality determination for non-financial information challenging. We found that preparers convert challenges into opportunities by using materiality disclosures as image enhancing marketing tools, which causes concerns regarding weak accountability and a deviation from the International Integrated Reporting Council's (IIRC's) objective of improving information quality. We found that IR preparers employ various techniques in conjunction to determine materiality levels, as well as whether to disclose non-financial information in their integrated reports. The institutional isomorphism lens used in the study highlighted the issues IR preparers faced in their determination efforts of IR materiality levels under mimetic and normative isomorphism pressures.

Research limitations/implications – The challenges and techniques identified can contribute to the development of a framework for materiality level determination for non-financial information.

Practical implications – Regulators who are concerned with ensuring sufficient information to improve investor decision-making will be interested in the techniques IR preparers use to determine materiality levels for non-financial information, in order to improve their regulations and frameworks.

Originality/Value – This study contributes to the literature regarding challenges with materiality level determination in integrated reports and techniques used by IR preparers. The application of an institutional isomorphism lens led to greater insight and understanding of IR preparers' challenges and techniques in materiality determination. This paper makes a number of significant contributions to the IR literature. Firstly, it identifies the usefulness of material information for decision-making and the influence stakeholders have on the materiality determination of non-financial information, which have not been mentioned in the prior literature. Secondly, the literature is silent on how organisations relate materiality to value creation for the purposes of determining the materiality content of an integrated report; this research provides empirical evidence of the use of value creation criteria in materiality determination. Thirdly, the study highlights that materiality is a combination of efforts that involves everyone in an organization. Further, strategy should be linked to IR and preparers have indicated that integrated thinking is required for materiality determination.

Keywords Integrated Reporting, materiality determination, non-financial information disclosures, institutional isomorphism.

Acronyms: Integrated Reporting (IR); Integrated Annual Report (IAR); International Integrated Reporting Council (IIRC)

1. Introduction

An integrated report is meant to provide a concise explanation of an organization's strategy, governance, performance and prospects, explaining how it plans to create value (de Villiers *et al.*, 2020). Therefore, it should “contain material information, both financial and other” (IIRC, 2015, p.25). However, while materiality forms the conceptual bedrock of corporate reporting, according to Eccles and Krzus (2014), there is no authoritative definition of this concept. There is, therefore, continuing debate and challenges relating to materiality determination.

The demand for corporate reporting transparency and an integration of financial and non-financial elements emerged during the global financial crisis around 2008 (de Villiers and Maroun, 2018). For example, PwC (2012, p. 5) considered that reporting was at a crossroads with no “clear link between economic drivers, financial information, and social and environmental impacts”. Similarly Stent and Dowler (2015) found that reporting processes lacked the integration, oversight and attention to future uncertainties required by IR. All material financial and non-financial information need to be disclosed in an integrated manner to enable investors to make informed decisions (Lakshan *et al.*, 2020). There have been several research calls to provide greater understanding of IR processes focused on the materiality determination process of IR preparers (Moolman *et al.*, 2016; de Villiers *et al.*, 2014; de Villiers *et al.*, 2017). As how materiality is determined, understood and implemented is seldom examined (Cerbone and Maroun, 2020, p. 2), this study explores the challenges confronting, and techniques used by, IR preparers in IR materiality processes, thus providing new insights into this conceptual bedrock of corporate reporting.

Previous studies on non-financial information materiality focused on how materiality was disclosed in integrated reports (ACCA, 2012; Solomon and Maroun, 2012), whether organisations had materiality processes (Stubbs and Higgins, 2014b), board characteristics and other determinants of materiality disclosure (Fasan *et al.*, 2017; Gerwanski *et al.*, 2019), auditors’ materiality judgements for non-financial performance indicators (NFPI) in IR (Green and Cheng (2019), and descriptions of how companies identify stakeholders (Beske *et al.*, 2020). These studies do not address the challenges IR preparers face and the internal mechanisms or techniques IR preparers use for materiality assessment. Cerbone and Maroun (2020) found that materiality assessment takes into account 1) an amalgamation of factors important to shareholders and other stakeholders, and 2) strategy, risk and long-term value creation. However, no information is provided on the challenges or techniques for amalgamation or to connect materiality assessment with strategy, risk and long-term value creation. Mio *et al.* (2020) investigates whether the materiality approach is different for IR and sustainability reporting, but once again do not deal with challenges or detailed mechanisms.

ACCA (2017) and Eccles and Krzus (2014) mention some of the challenges of the materiality assessment process, namely difficulty in reconciling 1) the needs of different stakeholders when determining materiality and 2) the different definitions of materiality in the International Integrated Reporting Framework (IIRF) and other standards/frameworks. Wee *et al.* (2016) mention the technique of a materiality matrix, weighting and ranking key performance indicators. However, no prior study provide a more complete overview of the challenges and techniques used to assess materiality for the purpose of IR, such as the current study aims to do. The research objective for our study is therefore to investigate the challenges of, and techniques for, materiality determination of non-financial information confronting IR preparers. We investigated three key research questions:

- RQ1 What are preparers’ perceptions regarding the determination of materiality levels for non-financial information in integrated reports?
- RQ2 What technique(s) did preparers use to determine materiality levels?
- RQ3 What issues/challenges did IR preparers encounter during the materiality determination of non-financial information for IR?

Sri Lanka in the South Asian region, where there is rapid economic growth, is an early adopter of IR (Lakshan *et al.*, 2020). Even though IR is not a mandated reporting requirement, an increasing number of Sri Lankan companies have followed the advice of their accounting profession and adopted IR (Gunarathne and Senaratne, 2017). Prior studies, however, have raised issues with regards to whether there is a “practice-reporting portrayal gap” (Adams, 2014). Gunarathne and Senaratne (2017) explain this gap as either a “lag” where companies’ integrated reports do not reflect their integrated thinking and performance or as a “lead” where companies report more than they really possess. Significantly, Gunarathne and Senaratne (2017) conclude that “Most of these [Sri Lankan] firms follow IR more for rhetoric purposes and they have not realized the meaning of IR other than to view it as another reporting mechanism” (p.541). These explanations justify the selection of Sri Lanka as a country to investigate the challenges IR preparers face in materiality determination of non-financial information disclosures in integrated reports.

We adopt a qualitative methodology in this study. Our research method was to collect data via a semi-structured interview approach. This data was analysed following the interpretative paradigm tradition. Our data consist of 55 interviews with IR preparers in 12 listed companies in Sri Lanka and further archival evidence from their integrated annual reports (IARs) over a three year period. In order to develop an in-depth understanding of materiality determination in IR, we targeted all individuals that were involved in integrated report preparation in the sample companies. The support from these companies enabled participation from all levels of management such as assistant managers, senior managers, directors, risk managers, auditors and chief financial officers. Because of this data collection approach, depending on the importance of IR in their companies, some companies provided a larger group of participants while others provided a much smaller number of interviewees.

Higgins *et al.* (2014), in their examination of Australian business organisations, are of the view that for early adopters where institutionalization of IR has been unfolding, isomorphism is likely to follow. We therefore apply an institutional isomorphism theory lens to the analysis of our data, which helps explain and shed further light on the findings. Our results indicate that IR preparers found materiality determination complex and challenging, and that a number of different techniques was used to determine materiality levels. While the findings are specific to the Sri Lankan country context and might not be generalizable due to contextual differences, such as the size of its capital market and its cultural and societal environment, what has been found in this study can raise awareness and provide meaningful insights to the issues related to IR materiality determination. The results of this study will be of interest to managers, preparers and consultants in considering techniques for materiality assessment of non-financial information to be disclosed in integrated reports. Researchers may use our findings to develop their theoretical thinking, potentially leading to further research projects regarding companies’ materiality assessment processes. For instance, similar to a study conducted by Madison and Schiehl (2021) that looked at the effect of financial materiality on environmental, social and governance (ESG) performance assessment, IR researchers could conduct a comparative analysis of different industries and use the Sustainability Accounting Standards Board (SASB) ESG financial materiality framework to rank the level of materiality disclosures in integrated reports. A comparative analysis in similar industries could also be conducted across countries. In addition, regulators, such as the IIRC, investor protection bodies, and stock exchanges may be interested in the impediments to materiality determination and the methods companies are using, in order to assess whether further regulation could improve the disclosure of decision-useful non-financial information.

The following sections first explain the literature on materiality in IR, institutional theory, and the research method. The paper then discusses research findings followed by the concluding remarks.

2. Materiality and Conciseness in Integrated Reports

One of the main IIRC guiding principles for IR is materiality. The materiality principle is key both to reach conciseness and to push companies towards the disclosure of information on their long-term performance (Mio and Fasan, 2014). Materiality plays a crucial role in determining the matters to be included in an integrated report and ensuring conciseness of the report (IIRC and American Institute of Certified Public Accountants, 2013). The IIRC stresses the need for all reported information to be material in nature to meet the changing information needs, “...only the most material information should be included in the integrated report” (IIRC, 2011, p. 4). To reiterate, materiality forms the conceptual bedrock of corporate reporting (Eccles and Krzus, 2014). IR “conciseness” is one of the key features stressed by the IIRF, and to gather a clear and accepted definition of materiality is, in the IR context, fundamental and much more important than for previous standards (Mio and Fasan, 2014). There is considerably less guidance and experience on assessing materiality in the context of IR (Hanks, 2012). Materiality determination in IR is infinitely more challenging because “information importance” is difficult to translate into monetary terms because the requirements for information pertaining to these broader dimensions are neither standardised nor clear (Steyn, 2014). The need for future research to focus on developing clear disclosure guidelines relating to materiality and stakeholder engagement was identified by Van Zyl (2013) and de Villiers *et al.* (2014).

The process of determining materiality is entity specific and based on industry and other factors, as well as multi-stakeholder perspectives (IIRC, 2015). Materiality is a firm-specific social construct (Eccles and Krzus, 2014). While a firm may undertake an involved stakeholder engagement process, it makes the ultimate decision as to what is material to its strategy. In doing so, firms exercise judgment as to what is both important and relevant to the user audience and, of equally symbolic importance, what is not relevant or important enough to report (Eccles and Krzus, 2014). There is no rule prescribing the frequency or precise approach of the materiality determination process. Judgement should be used when deciding if, and to what extent, a detailed assessment is needed (IIRC, 2015). What ultimately passes the materiality threshold for inclusion in an integrated report demands the exercise of judgment to separate the “material” from the “immaterial” (Eccles and Krzus, 2014, p. 122). Since a given factor’s relevance must be weighted by its importance to the company, the IIRC and American Institute of Certified Public Accountants (2013) indicate that judgment has to be applied in determining the information to disclose regarding material matters.

Wee *et al.*'s (2016) research on factors affecting preparers' and auditors' judgements about materiality and conciseness in IR revealed that many companies had a specific process for determining materiality that involved both internal and external stakeholders and a series of activities to identify, evaluate and prioritise material matters. Further, they found materiality judgements were associated with the magnitude and the likelihood of items that could potentially be disclosed and also that some companies used specific techniques, such as determining a materiality matrix, and weighting and ranking key performance indicators. Cerbone and Maroun's (2020) study focused on differences in IR practices in materiality determination process. They found that while market-dominated firms emphasise value-relevance for financial capital providers (an internal focus approach), professional logic interacted with a stakeholder logic within a broader perspective of materiality as an amalgamation of factors that are important for shareholders and other stakeholders to demonstrate compliance with codes of best practice.

Furthermore, IR offers a series of challenges to the management and the auditors of an organisation, including determining the materiality level for qualitative elements that are common in social and environmental disclosure (Adams and Simnett, 2011). IR brings new challenges to organisations when compared to sustainability reporting and it is closely linked to business strategy and value creation (Stubbs and Higgins, 2014b). The absence of regulations

for materiality level determination for non-financial information is a significant challenge for organisations. For instance, Bandeira and Pinto (2013, p.190) found “standardisation, comparability, materiality, complexity, stakeholder engagement, assurance and trust” as missing links in the integrated reports of their case studies.

3. Institutional Theoretical Lens

Institutional theory is one of the most dominant theoretical perspectives in organisational analysis (Lounsbury, 2008) and is increasingly being applied in accounting research (Abernethy and Chua, 1996; Bebbington *et al.*, 2009; de Villiers and Alexander, 2014; Dillard *et al.*, 2004; Sharma *et al.*, 2010, 2014; Tsamenyi *et al.*, 2006). Notably, some scholars have used institutional theory to draw useful insights into the adoption of IR (Mio *et al.*, 2020; Higgins *et al.*, 2014; Jensen and Berg, 2012; Wild and van Staden, 2013). According to institutional theory, organisations are embedded in a comprehensive system of political, financial, educational, cultural and economic institutions that exert institutional pressure on them (Jackson and Apostolakou, 2010; Matten and Moon, 2008) and “adopt structures and/or procedures that are socially accepted as being the appropriate organisational choice” (Carpenter and Feroz, 2001, p. 569). There is an overt institutionalisation agenda underway, as supported by the IIRC (Higgins *et al.*, 2014; Rowbottom and Locke, 2013).

DiMaggio and Powell (1983) argued that organisations must conform to institutional pressures if they wanted to gain legitimacy within an organisational field. These institutional pressures could occur from three sources namely coercive, mimetic, and normative isomorphism (DiMaggio and Powell, 1983). These forces are argued to apply different levels of motivations by institutions in the adoption of social patterns (Kostova and Roth, 2002) of which IR is considered to be an emerging social movement in the field of reporting (Eccles and Krzus, 2010b).

Coercive isomorphism arises from formal and informal pressure exercised on organisations by other stakeholders on which they depend and the expectations of the society in which they operate (DiMaggio and Powell, 1983). In support of this view, Judge, Li, and Pinsker (2010) confirm that coercive isomorphism stems from resource dependence and legitimacy concerns. Coercive pressures can arise from regulative forces and resource dominant actors (Touron, 2005) and relates to external factors, such as shareholder influence and government policy. This isomorphism arises because of pressure from powerful, critical stakeholders who want to change organisations’ institutional practices (Deegan, 2009).

Mimetic isomorphism stems from organisations modelling the practices of others, which are largely practices from rivals in the field (Jennings and Zandbergen, 1995; Scott, 2008). DiMaggio and Powell (1983) proposed the notion of mimetic isomorphism that was identified later by Scott (1995) as the cognitive pillar. This type of isomorphism, where companies often respond to uncertainty by replicating the actions of the most successful industry members, is mimetic in nature (Meyer and Rowan, 1977). In addition, mimetic isomorphism involves organisations trying to copy or improve upon other organisations’ practices to obtain competitive advantages in terms of legitimacy. The argument being that legitimacy is “a generalized perception or assumption that the actions of an entity are desirable, proper or appropriate within some socially constructed system of norms, values, beliefs, and definitions” (Suchman, 1995, p. 574).

Normative isomorphism arises from group norms to adopt particular institutional practices. Educational and professional authorities that directly or indirectly set standards for legitimate organisational practices are the source of isomorphic pressure known as normative isomorphism in new institutionalism (Matten and Moon, 2008). This isomorphism process occurs through two mechanisms: a transmission of norms by professionals, and the development of professional networks (DiMaggio and Powell, 1983). Organisations adopt

similar formal structures, such as accounting standards, under the pressures of organisational institutions, such as state laws and regulations, stock exchanges and the accounting professions (Kholeif, 2010).

3.1 Prior studies on use of institutional theory in IR research

It is suggested that the first IR adopter would become an organisational role model through the unfolding of IR institutionalisation and isomorphism (Higgins *et al.*, 2014). Lai *et al.* (2013) postulate that institutional factors may influence IR adoption. Jensen and Berg (2012) found that IR practicing companies differ significantly from those of traditional sustainability reporting companies in terms of the institutional conditions under which they operate. Van Bommel and Rinaldi (2014) suggest that the trajectory of IR is determined largely by outside legitimating forces. Wild and van Staden (2013) using an institutional theory approach assert that within a given financial environment and industry activity climate, firms seek advantages and benefits from early adoption of a new reporting regime such as IR. Eccles and Serafeim (2011a) claimed that potential pressure from large institutional shareholders in both public and private equities may stimulate IR implementation.

García-Sánchez *et al.* (2013) suggest that stakeholder influence from institutional perspectives on the extent of IR is significant at a country level. Eccles and Serafeim (2011a) postulated that the future of IR diffusion requires the existence of both market and regulatory forces in conjunction with institutional theory. For instance, voluntary IR adoption will compel corporations in an industry to emulate other leading firms' best practices. McNally *et al.* (2017) found that the companies participating in their study included information in their integrated reports because disclosure requirements were referred to in codes of best practice or in their competitors' reports; thereby referring to memetic isomorphism. Further, the accounting profession and the big accounting firms have a huge influence on the IR adoption decision as the IIRC's governing council is dominated by the accounting profession and multinational enterprises (Dumay *et al.*, 2017; Flower, 2014). Wild and van Staden (2013) assert mimetic isomorphism is a factor driving the early uptake of IR.

Cerbone and Maroun (2020) examined differences in IR practices using institutional logics as a theoretical framework. Mio *et al.* (2020) investigate the implementation of IR by Generali and the IR approach to materiality and the sustainability reporting approach. Using both organizational change and institutional logics theoretical lens, they found that IR led to the identification of different material topics more than sustainability reporting. According to their findings, institutional theory suggests that IR and sustainability reporting material topics are going to be significantly different because IR is mainly driven by a market logic, whereas sustainability reporting is inspired by a stakeholder logic. According to Adams *et al.* (2016), while institutional theory has "been helpful in shaping our general understanding of the adoption of a range of accounting and reporting approaches and techniques in particular organisational and industrial contexts" (p.285), the theory, "has not been used to aid understanding of why reporting approaches might evolve in different ways within specific settings or with respect to specific issues" (ibid). This argument places our study into context as it applies an institutional theoretical lens to explore the isomorphic pressures on IR preparers in their materiality determination of non-financial information.

4. The context - Sri Lanka

Sri Lanka is an island nation situated in the Indian Ocean off the southern coast of India with a total population of 21.4 million. The Securities and Exchange Commission (SECSL) and the Colombo Stock Exchange (CSE) governs Sri Lanka's securities market. Sri Lanka was one of the countries that participated in the IIRC IR pilot programme in 2011. At the commencement of this study, there were 295 companies listed on the CSE (2016) and by 2017, 40 of 295 Sri

Lankan companies had adopted IR, where its growth has become a market trend in the country (Howitt, 2017).

Sri Lanka has a unique setting to its IR adoption for an emerging economy. The Institute of Chartered Accountants of Sri Lanka (CASL) holds the sole authority for setting and adopting accounting and auditing standards in Sri Lanka. CASL applies several strategies to promote implementation of IR among listed companies in the country. For example, in October 2012, the CASL hosted the international conference on IR (Gibassier *et al.*, 2019). To accomplish the purpose, CASL issued an IR implementation guide during 2015. This guide incorporated the principles of the IIRC, the GRI and the UN Global Compact (CASL, 2015).

Sri Lanka is among the top countries in terms of IR adoption as a proportion of listed companies in the world (Gibassier *et al.*, 2019). Cooray *et al.* (2021) states that “many Sri Lankan companies have embraced IR, despite it being a voluntary practice leading to an increase in the number of IR adopters from 02 in 2011 to 83 by 2018” (p. 5). It appears that isomorphism pressures could be at play for the significant increase in uptake of IR by Sri Lankan companies (Eccles and Serafeim, 2011a; Lai *et al.*, 2013; Wild and van Staden, 2013; Higgins *et al.*, 2014). Gibassier *et al.* (2019) identified that there was a lack of in-depth IR research on developing countries such as Sri Lanka that had a high rate of IR adoption. The findings from prior studies, such as Gibassier *et al.* (2019) and Gunarathne and Senaratne (2017), suggest that IR may be seen as just another reporting mechanism in developing countries, making it important for Sri Lanka, a developing country, to be chosen for this study.

5. Research Methods

This study seeks to understand how companies determine materiality levels for non-financial information in their integrated reports. The study employed an exploratory qualitative research methodology that relies on semi-structured interviews and an archival research approach. An exploratory study is valuable as it allows a researcher to find out “what is happening; to seek new insights; to ask questions and to assess phenomena in a new light” (Robson, 2002). Semi-structured interviews are used to gather data which are analysed qualitatively as “these data are likely to be used not only to reveal and understand the ‘what’ and the ‘how’ but also to place more emphasis on exploring the ‘why’” (Saunders *et al.*, 2009, p. 321). The study uses a semi-structured interview guide since it allows the interviewer to explore, probe, and ask questions that will elucidate and illuminate the phenomena concerning materiality determination for non-financial information in integrated reports. We used the study’s research questions and related issues identified in the literature (de Villiers *et al.*, 2014) to develop our interview questions. Our interview guide served as a checklist during the interview to ensure that all relevant topics were covered (Patton, 2015). The guide was discussed and modified with academic experts in IR to enhance the face validity of the interview instrument and thereby the reliability of the interview data (Lichtman, 2013).

The archival research approach involved perusal of the annual reports and/or IARs from the 12 Public Listed Companies (PLCs) participating in the interview data collection process for the three years¹ 2014, 2015 and 2016 (for some of the company’s financial year end are 2014/15, 2015/16 and 2016/17) as we wanted to look at the reports before and after IR adoption. In total 36 IARs (produced after introducing IR) were examined². IARs validate the identified interview themes by either supporting interviewees’ comments or dissenting with their arguments. While the extracts of materiality level determination from IARs were not directly related to the interviewees to ensure anonymity, they were used to support or critique the comments of the interviewees.

¹ The pursued three years for Commercial Bank of Ceylon PLC’s annual reports consisted of years 2013, 2016 and 2017.

² Some of the sample companies name their reports as ‘integrated annual reports’ (IARs). However, some companies name the reports as annual reports and explain that the reports are IARs in the notes inside the report. Therefore, at times, the reader cannot judge the nature of the report just by looking at the name of the report.

5.1 Data collection

The researchers reviewed the annual reports of all the Sri Lankan PLCs in 2015 to identify whether they had adopted IIRC's IIRF and were producing integrated reports/IARs. At the time of this study, the researchers identified 32 Sri Lankan PLCs. The researchers approached the IR adopting companies and sought approval from higher-level management to interview employees involved in IR. Twelve PLCs consented to interviews being conducted. In total, 55 employees at different managerial levels (see Table 1) who engaged in integrated reports preparation were interviewed to explore broader perspectives of materiality determination for non-financial information. Although the number of interviewees appear large at 55, for reasons of confidentiality, we had to analyse interviews under the broader category of IR preparers as the identification of interviewees' roles would have compromised their anonymity within the 12 sample companies. Interviews were conducted with Risk Management Heads, CFOs, Managers, Executives, Accountants and others involved in IR.

Table 1: Profile of Interviewees

Industry Sector	Number of Companies	Number of Interviewees	Interviewees' Positions
Banking	3	20	Assistant Manager in Finance, Manager of Finance, Assistant General Manager, Assistant General Manager of Compliance, Deputy General Manager of Marketing, Deputy General Manager of Human Resources, Deputy General Manager of Management Audit, Manager of Risk Management, Executive of Administration, Executive, Chief Manager of Operations, Chief Risk Officer, Senior Manager of Finance, Head of Finance, Chief Financial Officer
Diversified Holdings	1	2	Assistant Manager, Group Finance Director
Finance	3	15	Assistant Manager in Finance (x2), Assistant Manager in Credit Risk Management, Assistant General Manager in Finance, Deputy General Manager in Finance, Deputy Manager in Finance, Junior Executive in Finance, Executive in Finance, Manager in Finance, Senior Manager in Finance, Senior Manager in Group Corporate Affairs, Manager in Treasury, Risk Management Head, Sustainability Head, Chief Financial Officer
Insurance	3	13	Assistant Manager in Finance (x2), Manager in Finance (x4), Executive (x2), Executive in Finance, Assistant Accountant (x2), Chief Operating Officer, Chief Financial Officer, Risk management Head
Motors	1	4	Assistant Manager, Manager in Finance, General Manager in Human Resources, Accountant
Telecommunication	1	1	Senior Assistant Manager
	12	55	

The validity and reliability of the interview data started with the selection of companies for the study. Purposive sampling techniques were used as it can form a sample that likely provides the in-depth information relevant to the study's research question (Marshall, 1996; Silverman, 2006). The study's purposive sample selection was based on each individual's involvement in

the IR process at his/her company. The interviews probed the issues, challenges and techniques employed by the IR preparers in determining the materiality levels.

5.2 Data Analysis

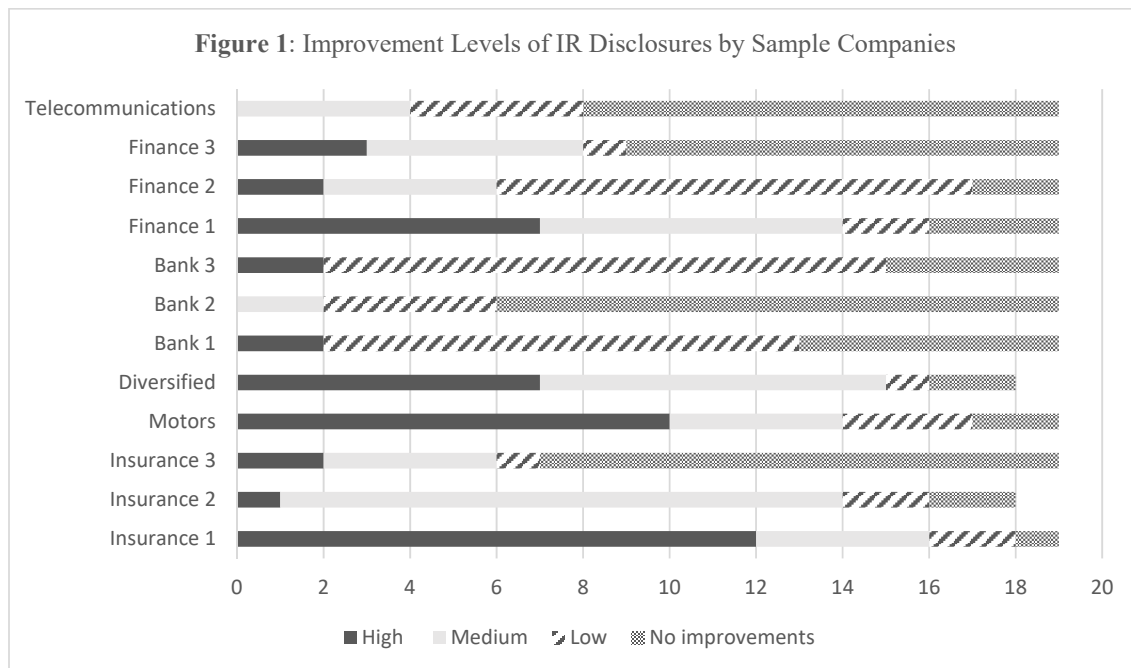
This study thematically coded the semi-structured interview data (Roulston, 2001) using a Computer Assisted Qualitative Data Analysis Software (CAQDAS), NVivo version 11. The use of the NVivo software has facilitated the process of organising, re-arranging and managing the considerable amount of qualitative data. Thematic analysis is a common qualitative analytic method (Roulston, 2001). It identifies, analyses and reports patterns (themes) within data (Braun and Clarke, 2006). It interprets various aspects of the research topic (Boyatzis, 1998), and it enables the researcher to answer the questions of “who says what, to whom, why, how, and with what effect?” (Babbie, 2015). Thematic analysis offers a tool to understand the motivation and impediment of corporate social reporting practices. It can help identify specific trends, attitudes, or content categories from the text, and draw inferences from them (Jones and Shoemaker, 1994). The NVivo software package assists with the analysis and coding processes. Codes were derived from the interview data based on the actual words or terms used by the interviewees, which included text at phrase, sentence, and paragraph levels. Codes were grouped into categories and then classified into themes as patterns emerged within the data (Neuman, 2006; Patton, 2005). The thematic analysis used in our qualitative study therefore provided a technique for breaking up our interview text to find “*within it explicit rationalisations and their implicit signification*” (Attride-Stirling, 2001, p. 388) which enabled our study “*to unearth the themes salient in a text at different levels*” (ibid).

6. Findings and Discussion

This study’s objective is to investigate the challenges of, and techniques for, materiality determination of non-financial information confronting integrated report preparers. The findings and discussion section is organised to provide answers to the three key research questions. In Section 6.1, the three key themes relating to IR preparers’ perception on materiality level determination were the level of management involved in this determination, information overload, strategy and competitive advantage. In Section 6.2 on challenges confronting IR preparers in materiality determination, five key themes were identified relating to stakeholder prioritization and engagement, subjectivity and entity specific concept, inadequate guidance and regulation, lack of IR reporting experience, and avoidance in reporting negativity. For Section 6.3 on techniques used to determine materiality levels, three main themes were identified relating to stakeholder focus and analysis, KPIs and value creation, and judgement and benchmarking. We commence the findings discussion by providing a comparative analysis of our archival review of three years of integrated reports of the 12 companies that participated in this study. This comparison was based on annual reports before IR adoption and after IR adoption. We wanted to assess whether the integrated reports provided a holistic picture of the organisation; an improved recognition/image of the organisation; an improvement in the quality of information, reporting, and accounting reports; an improvement in strategic and process planning; information process developments; an integrated corporate culture and improved their communication. We aligned these points against the ten expected benefits the IIRC (2011) outlined for communicating value in the 21st century through integrated reporting, namely 1. better alignment of reported information with investor needs; 2. availability of more accurate non-financial information for data vendors; 3. higher levels of trust with key stakeholders; 4. better resource allocation decisions, including cost reductions; 5. enhanced risk management; 6. better identification of opportunities; 7. greater engagement with investors and other stakeholders; 8. lower reputational risk; 9. lower cost of, and better

access to, capital and 10. greater collaboration across different functions within the organisation (summarised from IIRC (2011, p. 21), see Table 2). We were unable to analyse the ninth IIRC benefit, as cost information was not available.

Our archival research analysis³ found that only the area of ‘enhanced risk management’ shows significant improvements in the IR disclosures. Across all 12 companies, there were 8 (67%) companies that carried a High rank and only 1 (8%) company has a Low ranking. The next area to show significant improvements related to ‘greater engagement with investors and other stakeholders’ which showed 2 High (17%), 7 Medium (58%) and 3 Low (25%) rankings. Interestingly, 6 companies had High ranks for ‘lower reputational risk but the other 6 companies showed no improvements in their reporting in this area. Figure 1 provides an overview of the improvement levels of IR disclosures of the 12 companies over the archival research period. The figure shows that 4 (33%) companies had significant ‘No improvements’, 3 (25%) companies had significant ‘Low improvements’, 1 (8%) company with significant ‘Medium improvements and only 2 (17%) companies with ‘High improvements’ from the 19 IIRC areas⁴ that were reviewed against our 8 viewpoint areas. Importantly, with regards to the research calls for conciseness, improved performance reporting and process improvements directions in IR (Wee *et al.*, 2016), the ranking was either ‘Low’ or ‘No improvements’. This finding indicates that IR in Sri Lanka still has some way to go to achieve the objective of IR to communicate value in the 21st century.



³ We applied an interpretative ranking system of High, Medium and Low to the level of improved IR disclosures provided by the sample companies over the 3 year-period. This interpretation can be quite subjective as we were looking for any changes/improvements in the 19 IIRC areas that were in the IIRC list (see Table 2).

⁴ Table 2 shows 22 areas in total as 3 areas were not in the IIRC list but identified from the IR literature.

Table 2: Comparison of achieved improvements/benefits with IIRC’s expected improvements/benefits from archival research of integrated reports

Achieved Improvement (Our Analysis)	IIRC expected improvements/benefits	Insurance	Finance	Motors	Insurance	Diversified	Bank	Bank	Bank	Finance	Insurance	Tele-Communications	Finance
1. Helped to provide a holistic picture of the organisation	1. better alignment of reported information with investor needs	H	M	H	M	H	L	-	L	L	-	-	-
	2. availability of more accurate non-financial information for data vendors	H	M	H	M	M	L	-	L	L	-	-	-
	5. enhanced risk management	M	H	H	M	H	H	M	H	H	H	L	H
	7. greater engagement with investors and other stakeholders	H	H	M	M	M	L	L	L	M	M	M	M
2. Improved recognition/image of the organisation	7. greater engagement with investors and other stakeholders	H	H	M	M	M	L	L	L	M	M	M	M
	8. lower reputational risk	H	H	H	H	H	-	-	-	-	-	-	H
3. Improved the quality of information, reporting, and accounting reports	1. better alignment of reported information with investor needs	H	M	H	M	H	L	-	L	L	-	-	-
	2. availability of more accurate non-financial information for data vendors	H	M	H	M	M	L	-	L	L	-	-	-
	3. higher levels of trust with key stakeholders	-	-	-	L	-	-	-	-	-	-	-	-
	Conciseness **	-	-	L	-	-	-	-	-	-	L	L	-
4. Supported strategic planning	4. better resource allocation decisions	M	-	L	-	M	-	-	-	L	L	L	L
	5. enhanced risk management	M	H	H	M	H	H	M	H	H	H	L	H
	6. better identification of opportunities	M	-	-	L	L	-	-	-	L	-	L	M
5. Supported process improvement	7. greater engagement with stakeholders	H	H	M	M	M	L	L	L	M	M	M	M
	Improved performance monitoring**	L	L	L	L	-	L	-	-	-	-	-	-
	Process improvements**	-	L	L	L	-	-	-	-	L	-	-	-
6. Information process develop	1. better alignment of reported information with investor needs	H	M	H	M	H	L	-	L	L	-	-	-
	2. availability of more accurate non-financial information for data vendors	H	M	H	M	M	L	-	L	L	-	-	-
	7. greater engagement with investors and other stakeholders	H	H	M	M	M	L	L	L	M	M	M	M
7. Helped to Create an integrated corporate culture	10. greater collaboration across different functions within the organisation	L	L	L	-	-	-	-	L	L	-	-	-
8. Communication improved	1. better alignment of reported information with investor needs	H	M	H	M	H	L	-	L	L	-	-	-
	10. greater collaboration across different functions within the organisation	L	L	L	-	-	-	-	L	L	-	-	-

Ranked level of Achieved Improvements: **H** High **M** Medium **L** Low - No improvements

** Expected improvements which are not in the IIRC list but in the IR literature

Note: For confidentiality purposes linked to interviews, companies are not identified by name

6. 1 IR Preparers' perception on materiality level determination of non-financial information

Our analysis of IR preparers' responses provides evidence of significant isomorphic pressures placed on them to provide material non-financial information. Top management placed significant pressure over IR preparers to provide concise and strategic material disclosure information that also portrayed a competitive edge for their companies. This finding confirms that institutional pressures are being imposed on IR preparers (Jackson and Apostolakou, 2010; Matten and Moon, 2008) to follow procedures as dictated by its organisation (Carpenter and Feroz, 2001). Coercive pressures are at play because of regulative forces (stock exchange, accounting bodies) and resource dominant actors (shareholders) (Touron, 2005). Cooray *et al.* (2021) found that the increasing extent and trends of IR coverage in Sri Lankan companies denoted that IR was increasingly becoming institutionalised because of the external normative and mimetic pressures in this country. Gunarathne and Senaratne (2018) explain that the Sri Lankan professional accounting bodies' IR award schemes for best reporting entities place significant normative pressures toward IR adoption by Sri Lankan companies, which at the same time also instigate mimetic pressure as companies influence their peers in the industries to follow suit. All interviewees⁵ give high importance to the materiality determination for non-financial information. They indicate that matters are discussed and determined at top management and/or strategy meetings.

That is basically coming from the top because of its importance. The top management involvement is very much essential in order to identify the material factors. We do have group discussions with the top management basically the CEO, the Chief Operations Officer, CFO, the finance team, and the people who are involved in the annual report. We get together and discussed what sort of material aspects that the company is disclosing.
(IRP 12)

Materiality decisions must seek to avoid information overload, and the obfuscation of core issues (Mio and Fasan, 2014; IIRC, 2015). This viewpoint is reinforced by an interviewee who comments:

We don't put all the crap, we don't dump there. Then the integrated sense also won't be there, then our information is overloaded.
(IRP 11)

Citizens Development Business Finance PLC provides an example of how one company demonstrates its material level determination (see Figure 2). The company focuses on materiality levels to provide important financial and non-financial performance indicators that reflect the company's ability to remain commercially viable and socially relevant to the communities in which it operates. The evaluation of Figure 2 suggests mimetic pressure as the company is justifying its legitimacy through appropriate actions within a socially constructed system of norms, values, beliefs, and definitions (Suchman, 1995). The 2016/17 IAR shows that the company has improved its prior years integrated reports on material matters by presenting the determination process that: highlights material determinants and material drivers, prioritises material aspects, and uses a materiality matrix (Citizens Development Business Finance PLC, 2016/17).

⁵ Interviewees are indicated as IRP and a number for confidentiality reasons. IRP is used to represent 'Integrated Report Preparer'.

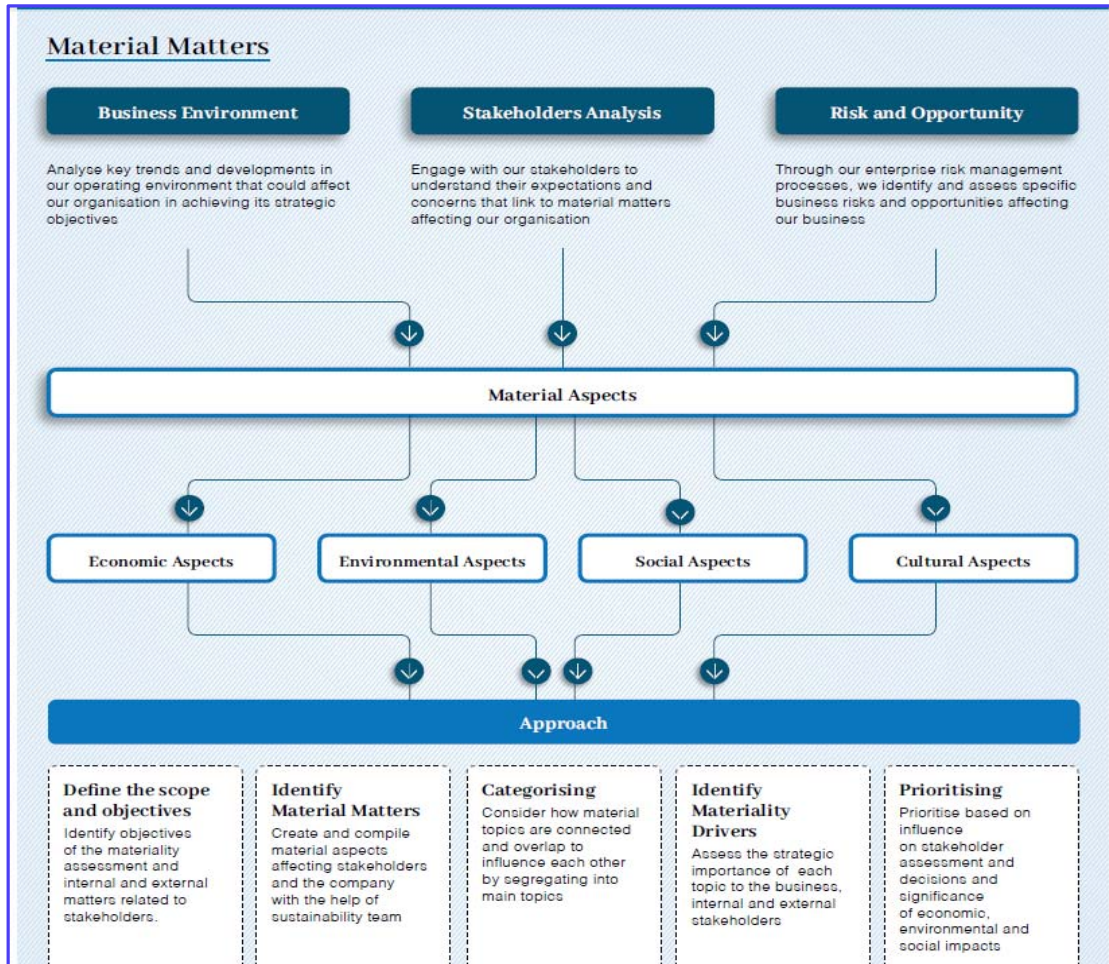


Figure 2 - Material Matters (Source: Citizens Development Business Finance PLC, 2016/17, p. 52)

The emphasis on material matters and disclosures of core matters in the organisation should improve internal and external decision-making because there is improvement in the quality of information to enable a more efficient and productive allocation of capital (IIRC, 2015). Again we see the presence of mimetic isomorphism pressures in our findings because these pressures occur when organisations copy or improve upon the other organisations’ practices to obtain competitive advantages in terms of legitimacy (Suchman, 1995). Suggestive of mimetic pressures, two interviewees highlight the positive impact of materiality in non-financial disclosures on ‘the brand’ of the company:

It will be making more brand visibility and your presentation how do you say your openness in presenting. This will create definitely a positive perspective, the positive impact to brand. (IRP 54)

It’s like you provide what is giving you an edge over others. For example, we have given a diagram saying that these are the products we are offering to the customers and exclusive products and services only our bank is offering to the customers. This is like a competitive analysis also. (IRP 38)

An interviewee explains the possibilities for companies to use materiality disclosures strategically in their marketing materials to gain competitive advantage:

Banking industry is really an open industry. So then you can't have a strategy that is unique to our bank. If we are following a kind of a strategy within minutes others will get to know. So you can't say that maybe a kind of a competitive advantage and we are not publishing those things. In my opinion those are the sort of marketing materials also. We have to talk about that and get more business and we can improve our competitive advantage by maybe publishing non-financial information. (IRP 28)

However, our findings raise an important issue regarding preparers' perception of materiality determination. Interviewees do not mention achievement of enhanced decision-making as a reason for the materiality assessment process in IR as foreseen by the IIRC. Instead the responses evidence an unintended outcome where companies appear more interested in materiality disclosure as a marketing or branding tool to achieve competitive advantage.

6.2 Challenges of determining materiality in IR

In Sri Lanka, initiatives by a progressive accounting profession and active propagation of voluntary disclosure practices that includes the business community, have referred explicitly to the IIRF (Cooray, *et al.*, 2021) have placed normative isomorphic pressures on IR preparers. There is a need for a higher degree of compliance and coverage of content elements. For example Cooray *et al.* (2021) states that "compliance with IIRF has become (or is becoming) an important institutional norm in the Sri Lankan voluntary reporting landscape and strategic consideration for the management of an organisation" (p. 8). However, implementing materiality in an IR context is challenging (Climate Disclosure Standards Board *et al.*, 2016; Ernst & Young, 2013a; IIRC, 2015; IIRC and American Institute of Certified Public Accountants, 2013; Wee *et al.*, 2016). The preparers in our study definitely view materiality determination for non-financial information as a challenging task. The findings identified five key themes relating to stakeholder prioritization and engagement, subjectivity and entity specific concept, inadequate guidance and regulation, lack of IR reporting experience and avoidance in reporting negativity as challenges related to IR non-financial information materiality determination.

Interviewees emphasised that materiality determination is complex because they perceive non-financial information as being non-quantifiable, and they link this issue to risk management. Illustrating normative pressures through risk management and governance processes, one interviewee comments:

It's the management challenge to filter top priority. The materiality issue really links with the risk management and governance process. You have to be vigilant all the time and to filter those key materiality issues. (IRP 54)

In Figure 3, Softlogic Insurance PLC (2016) based on the extent of power and interest of each stakeholder category, shows that stakeholder prioritization is the key to filter materiality of the company's non-financial information. This company believes that a comprehensive process of prioritizing is necessary for the better understanding and monitoring of its stakeholders and their needs.

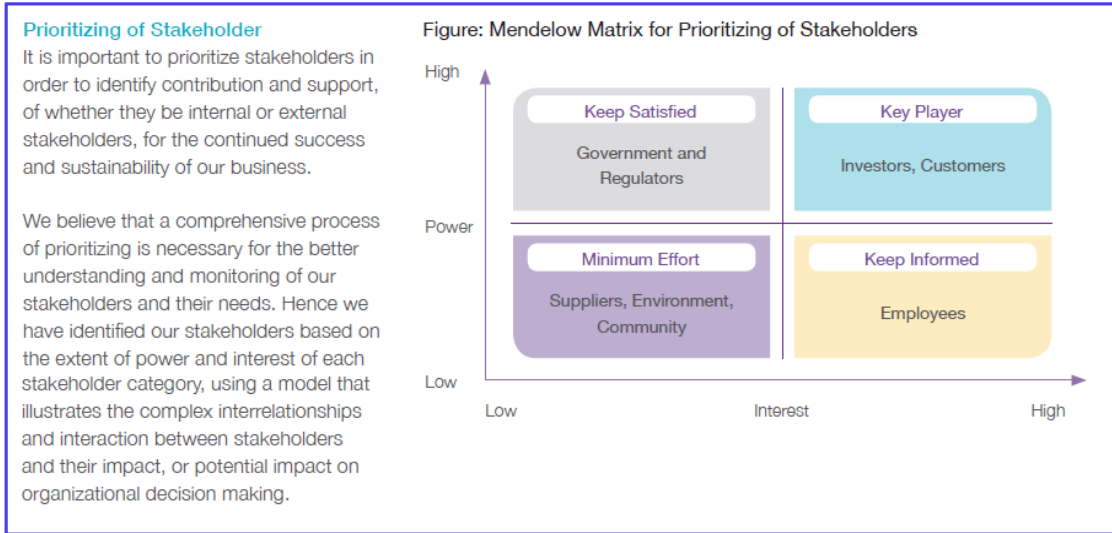


Figure 3 - Prioritizing Stakeholders (Source: Softlogic Insurance PLC, 2016, p. 59)

We found that preparers turn the challenge of determining materiality levels by using IARs as a marketing tool to obtain a competitive advantage. All the interviewees are of the view that materiality level determination for non-financial information is a difficult task because, as indicated by Stubbs and Higgins (2014), there are few regulations or guidelines available to determine the materiality levels for non-financial information. It makes the materiality determination a challenge for IR practicing companies. The lack of experience by the IR preparers also makes the situation more challenging:

One difficulty was the lack of expertise. Of course, at that time there were not enough reading materials around. There was no person for us to talk to and get information. Lack of expertise was one major weakness and lack of resources to get information was another difficulty that we faced (IRP 2).

Accounting professionals and standard setters indicate challenges associated with implementing materiality in an IR context (Climate Disclosure Standards Board et al., 2016; Ernst & Young, 2013a; IIRC, 2015; IIRC and American Institute of Certified Public Accountants, 2013; Wee et al., 2016). Materiality is difficult to establish for ‘non-financial’ factors (ACCA, 2012), and it is a challenge for management (Adams and Simnett, 2011; Steyn, 2014). One interviewee commented on the necessity to have a regulatory framework for determining materiality levels:

Yes, there can be instances that we are not disclosing, this may be because we feel that it is not necessary for a reader to know about these things. Some subjectivity is there, I’m not denying it. For an example, near misses or near losses. The best way of overcoming the difficulty of the materiality of non-financial is to come up with a regulatory framework and say that at least these requirements also need to be there. (IRP 30).

Materiality is an entity-specific concept (IIRC, 2015). According to the IIRC, the implementation of the materiality principle depends on the materiality determination process, which is entity-specific and based on industry and other factors, as well as multi-stakeholder

perspectives (IIRC, 2015). However, this approach gives rise to the problem of subjectivity as indicated by IRP 30's response above. Uniformity is an important factor to consider in corporate reporting and greater uniformity is necessary because it facilitates comparability, and acts as a regulator of quality information (Bernstein, 1967). This is therefore another challenge for IR preparers, because IR preparers see materiality as an entity-specific concept. However, this concept preclude uniformity and favours subjectivity. Importantly, based on our interviews, it is necessary to have guidelines or standards which, given similar circumstances (e.g. sector specific), will help integrated report preparers to arrive at similar materiality conclusions regarding non-financial information. The following statement is indicative of preparers' view that materiality determination is entity-specific:

If you take another organisation for the same factors, they might have a different way of determining the materiality. (IRP 16)

The findings indicate that interviewees find materiality determination problematic because the structures, business processes, work patterns, organisational culture, and values vary from organisation to organisation. Even though there are normative pressures, preparers indicate that IR guidelines are too general to help in materiality determination. While materiality can assist organisations by including information in the integrated reports, which brings publicity to the company and its products and services, it can also create issues about what might be 'desirable' disclosure (this direction is suggestive of mimetic pressures coming into play as companies observe what the other is providing in their material non-financial disclosures). This particular issue raises further challenges regarding the disclosure of material non-financial information, because interviewees also expressed concerns about sharing 'competitive advantage' information. The challenges identified in this study supports Stubbs and Higgins's (2014) finding that the use of IR demonstrates a weak accountability level for stakeholders because it is seen more as an image-building, marketing tool.

A further challenge is in regards to stakeholder engagement; an important concept in IR (IIRC, 2015). However, sometimes the stakeholder engagement may not happen as expected. Some interviewees indicate that there can be a disruption in the two-way communication between the organisation and their stakeholders which might lead to difficulties in determining materiality:

The organisation thinks this is material. But, for it to be material, the other party also should agree. Until that happens all the materiality levels that each organisation disclose in the annual reports may not be correct. If someone is not happy or not in agreement with that they should come and talk to the organisation. That tendency is not there. If this feedback comes only I think we can improve our way of reporting. (IRP 25)

Without appropriate stakeholder engagement it would be difficult for the organisation to determine relevant materiality levels of non-financial information. This could subsequently impact upon the benefits of conciseness and disclosure of information on the long-term performance of an organisation. Furthermore, companies could use materiality to exclude negative information (Unerman and Zappettini, 2014). A few preparers are of the view that organisations prefer to report only positive aspects rather than both positives and negatives.

If that is a positive thing, we will be reporting it. Reporting of negative things that depends. If it has any benefit to either of the stakeholders like internal or external, then it is positive. (IRP 03)

What preparers consider to be material appears to be influenced by what is best for the entity by such actions as promoting products and services and selectively choosing to report only the positive aspects of their activities. Therefore it can be questioned whether the IR practicing companies are encompassing the information that is required for informed decision-making by stakeholders. This finding supports Flower's (2014) viewpoint where the IIRC Framework "leaves far too much discretion to the firm's management" (p.10) and the preparers may "hijack" the content and level of disclosure in the integrated reports (ibid). Significantly, it was found that some sample companies used IR as an image building reputational tool, which obviously is a deviation from the IIRC's objectives of IR. Unerman and Zappettini (2014) argue that companies use materiality to exclude negative information and rhetorically report an image of sustainability that differs from their underlying behavior. This contradicts the IIRC requirement (IIRC, 2015; IIRC and American Institute of Certified Public Accountants, 2013) that the materiality process should be applied to both positive and negative matters, including risks and opportunities and favorable and unfavorable performance or prospects.

When compared with financial information, the lack of guidance and experience on assessing materiality in the IR context (Hanks, 2012), makes the materiality determination more challenging. Furthermore, materiality determination in IR is infinitely more challenging because "importance" is difficult to translate into monetary terms (Steyn, 2014). To compound this challenge is that the little guidance offered by the IIRC is based on principles which allows for significant variation in the way companies may apply the materiality principle and develop their "materiality determination process" (Lai *et al.*, 2017). Our findings in Section 6.3 indicate that interviewees followed the GRI guidelines in their efforts to determine the appropriate levels of materiality.

6.3 Techniques used in IR materiality level determination

The analysis of techniques that preparers use to determine materiality levels in IR reveal eight techniques and have been broadly categorised under three main themes relating to stakeholder focus and analysis, KPIs and value creation, and judgement and benchmarking. To provide more insightful meanings in which preparers decided on the techniques they used in materiality level determination, an institutional isomorphism lens was used to interpret the findings.

6.3.1 Stakeholder Focus and Analysis

One important consideration for IR preparers is the impact of the organisation's operations on stakeholders. Subsequently preparers focus on techniques that include stakeholder analysis, usefulness of information for decisions, and impact on stakeholders. The IIRC stresses the importance of materiality and stakeholder engagement: "The materiality determination process has to be integrated in the everyday management of the organisation and includes regular engagement with the primary intended report users to identify their information needs" (IIRC, 2013, p. 21). Therefore, IR preparers could have been formally and informally pressured by the actions of the IIRC, IIRC supporting organisations, shareholders and other stakeholders in the coercive isomorphic form. The majority of interviewees mentioned 'global trend' as a reason for their application of materiality in IR:

It's a global trend as well as a Sri Lankan trend. Therefore, we were keen to adopt IR principles (IRP 48).

Normative isomorphism assumes organisations adopt the structures and procedures advanced by particular dominant professions, professional bodies and/or consultants. The normative isomorphic process relates to the pressures emerging from common values to adopt particular institutional practices (DiMaggio and Powell, 1983). CASL is the authoritative body in Sri Lanka for financial reporting. CASL has the ability to influence Sri Lankan companies towards the adoption of IR and practice IR guiding principles by means of their auditors and qualified members. In addition, CASL conducts seminars and round table discussions about IR and has issued an implementation guide for IR. CASL organises an annual reports awards competition including special awards for best-integrated reports in the country. The actions of CASL as a key professional stakeholder suggest a strong normative isomorphic pressure in place for IR in Sri Lanka.

The “Big 4” accounting firms have played a profound role in the globalization of accounting and represent normative pressure (Albu *et al.*, 2011). The big accounting firms in Sri Lanka also appear to be influential actors who exert normative pressure on the application of materiality in IR. Their persuasion ranged from ‘urging’, which suggests some pressure, to ‘helping’ For instance, “Ernst & Young were behind us, urging us to move to IR” (IRP 42); and “The external auditors, especially the big four audit firms, have helped us by arranging certain training sessions” (IRP 11).

Other stakeholders included annual report design companies⁶ that provided considerable impetus for the sample companies to introduce IR. These external stakeholders possess knowledge and expertise in producing IARs.

Our annual report was facilitated by an annual report agency for about five to six years. They provided us with really good support to move to IR. They were very helpful in facilitating this process. They had the necessary knowledge and shared it with us.
(IRP 10)

This is an important finding because the influence of the annual reports design companies in IR adoption and materiality determination decisions of Sri Lankan companies is a new finding not previously mentioned in the IR literature on isomorphic influencers.

6.3.1.1 Stakeholder analysis

A firm can be coerced by its influential or powerful stakeholders into adopting particular reporting practices (Deegan and Samkin, 2013; Eccles and Serafeim, 2011a). Sri Lankan PLCs could have powerful stakeholders including institutional investors locally and globally. These stakeholders have power to influence companies to adopt IR and practice materiality for better transparency. Obtaining stakeholder perspectives is important in deciding materiality levels (IIRC, 2015; IIRC and American Institute of Certified Public Accountants, 2013). One interviewee explains:

⁶ Companies that provide services to companies to design their annual reports in an attractive manner. This is an outsourcing of annual report designing part to experts in the field who possess skills and knowledge to design annual reports.

Stakeholders' feedback is a major input of the non-financial things we are reporting.
(IRP 44)

Another interviewee comments on stakeholder analysis and the materiality level determination:

That is not that we just think and decide. That is based on the analysis that we do on our stakeholders. Maybe the previous correspondence, communications that they have. That is basically based on the understanding that we have on our stakeholders and the results of certain correspondence that we have with them. For example, when investors' interests are growing and they are questioning about a particular section, if we have not reported, we start thinking these are material ones and we need to add up.
(IRP 11)

Coercive isomorphism is also found to stem from shareholders. Funds used to finance the companies are obtained from shareholder capital and borrowings. Some interviewees state that pressure from their shareholders influenced them to introduce IR:

At our AGM, some shareholders question why we are doing these bulky reports. They sometimes complain that they can't read all these things. This encourages us to move towards IR and materiality in IR.
(IRP 47)

Citizens Development Business Finance PLC (2016/17) illustrates how it considers matters important to stakeholders when determining the materiality of non-financial information. The company starts by engaging stakeholders to understand their expectations. The process includes defining the scope and objectives of materiality assessment, identifying material matters, categorizing, identifying materiality drivers, and prioritization (refer to Figure 2). The findings indicate that the success of the materiality level determination depends on identification of intended report users and the decisions that they need to make.

We have built up a materiality matrix considering the interest and influence of all our stakeholders. We map the stakeholders into that matrix every year and we identify what are the most important information required by the stakeholders and produce the information. We go into the shoe of the stakeholder and think whether this information is really required to make a very good solid decision about the company and if we feel so yes we give that information to our stakeholders. That is one of the main reasons why we disclose our negative aspects.
(IRP 21)

A key finding was that interviewees considered that the materiality principle is strongly linked to the principle of stakeholder-responsiveness and subsequently allowing IR to become more responsive to individual organisations and to the needs of their stakeholders. It is highlighted by the interviewees that stakeholder engagement is necessary to identify the key stakeholders and their priorities. Sometimes, it is not possible to communicate with all the stakeholders at the same level. The identification of key stakeholders and the stakeholder engagement process of one company is outlined:

Based on the stakeholder engagement model we identify who are the important stakeholders and their priorities. We understood that we are unable to communicate or inform all the stakeholders at the same level. We have the responsibility and give more priority to identify stakeholders also. So, keeping in mind the stakeholders' importance and their systematic approach, we thought that is the best approach we can take. It depends on to whom that is material. (IRP 02)

All the interviewees believed that their materiality determination for non-financial information is based on stakeholder analysis and investor requirements; as has been suggested by International Association for Accounting Education and Research *et al.* (2016).

6.3.1.2 Usefulness of information for Stakeholders' decisions

The materiality determination process is required to be disclosed in an integrated report to enable the intended report users to understand how decisions to include or exclude matters were made (IIRC, 2013). It appears also that international shareholders applied pressure on one company to produce integrated reports.

In our company, out of the top twenty shareholders, twelve are from outside the country, with access to large overseas funds. When we go to investor forums and take part in campaigns outside Sri Lanka, these overseas shareholders want IR. They want to receive these integrated reports. Because of that, we changed the reports. (IRP 47)

The pressure from large institutional shareholders who hold significant equity suggest coercive isomorphism for IR adoption. Some interviewees commented that the materiality level of non-financial information is primarily focussed on valuable and relevant information for a decision maker.

It depends on the relevance to the external party to make decisions about the company. We set our material level for non-financials based on the relevance of the information to the decision maker. (IRP 53)

6.3.1.3 Impact on stakeholders

Most of the interviewees commented that they consider the impact of information on stakeholders to determine materiality levels for non-financial information. For instance, an interviewee explains how the impact of information on stakeholders is decided based on stakeholder feedback, which determines the materiality level:

The materiality of non-financial information is decided considering the extent of impact on the stakeholders, as well as on the bank. It could be a concern raised by some party, but the impact may be high for the bank. (IRP 26)

The IAR (2016) of Sri Lanka Telecom PLC explains that the impact is measured through the 'importance' of each aspect which takes into consideration both its relevance and significance. Mio and Fasan (2014) explain that this technique helps to avoid information overload, and obfuscation of core issues. KPMG (2012b) write that the stakeholder assessments appear to have helped the companies to identify a complete picture of business challenges and opportunities. In this respect, materiality has been much less of an issue than many had originally anticipated.

6.3.2 KPIs and value creation

A focus on value creation and the use strategy and KPIs linked to organisational strategy provide different perspectives on materiality determination approaches used by the preparers in this study.

6.3.2.1 Value creation

An organisation’s ability to create value over the short, medium and long term is affected by its strategy, business model and capitals that it uses. An important criterion to identify material matters is the possibility of affecting an organisation’s ability to create value (IIRC, 2013d). Preparers explained that materiality level was based on value creation for the company and stakeholders.

Non-financial sections materiality level is decided based on how this area is important to the company and to the society. That is how we create value for the company and to our customers, stakeholders. (IRP 01)

At present, our plan is to communicate whatever the value additions. The type of value additions that we have created. We can directly put numbers but the value additions, we have to elaborate value additions in our capitals. So, we focus on the values that we have added to the society. That is our focus, the value additions. This is difficult. (IRP 09)

For example, through the stakeholder engagement process, Citizens Development Business Finance PLC (2016/17) identifies ‘Talent Acquisition’ as one of the aspects of human capital which is very important to the organisation’s ability to create value over the short, medium and long term. The ‘Talent Acquisition Model’ has been presented in their IAR (see Figure 3).

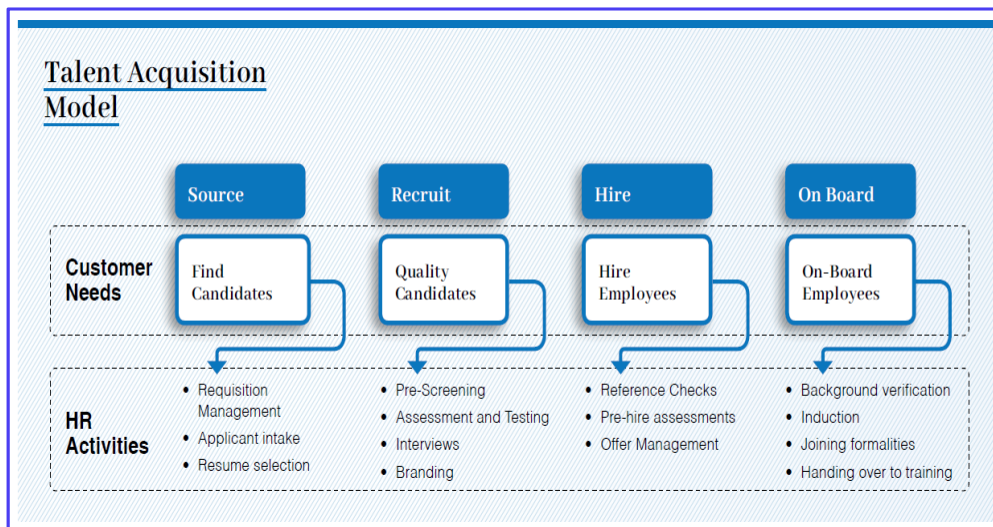


Figure 4: Talent Acquisition Model (Source: Citizens Development Business Finance PLC, 2016/17, p. 93)

The analysis of IARs of the sample companies indicate that ascertaining and reporting value addition and value creation takes different forms depending on the company. An extract (see again Figure 1) from Citizens Development Business Finance PLC, IAR (2016/17) illustrates materiality determinants and drivers that help to determine value additions for different aspects.

For example, their value additions have four dimensions; economic, social, environmental and cultural. Some preparers identified IR as value taken and value given. They share how the companies determine materiality based on value creation to various stakeholders or based on impact on the value creation of the organisation:

Materiality for non-financial information is determined in terms of value creation. Because at the end of the day integrated reporting is value taken and value given out. So, the materiality also should be looked at in terms of the value created to the various stakeholders. (IRP 27)

The IIRC (2013d) explains that a matter is material if it could affect the organisation's ability to create value over the short, medium and long-term. In determining whether a matter is material, companies should consider whether the matter substantively affects, or has the potential to substantively affect, the organisation's strategy (IIRC, 2013d). Strategy has a huge impact on value creation. Any actions needed to achieve strategic objectives could be included in the integrated report. To the researchers' knowledge the literature is silent on how organisations relate materiality to value creation for the purposes of determining the content of an integrated report. This is probably due to the general lack of empirical studies on how organisations implement IR. The use of value creation criteria in materiality determination is a significant finding of this research.

6.3.2.2 Strategy and KPIs linked to strategy

Embedding the materiality determination process into management processes can enhance the efficiency and effectiveness of decision-making and reporting. The extent to which integrated thinking underpins the materiality determination process, and is linked to board and management discussions, is also important (IIRC, 2015). The organisation's strategy has always been central to the integrated report, and materiality is inextricably linked to strategy (Lai *et al.*, 2017). Some preparers identified the relationship between strategy, KPIs and the materiality of non-financial information disclosures.

It is coming from our strategy. Materiality for non-financial things cannot be defined by any number, any quantitative thing. What happens is, if it is part of our strategy that has a material KPI to disclose. So, they decide the framework and if it is within that framework that becomes a material information to be reported in the integrated reporting framework. Very simply, we look at governance as part of our key strategy, for example, our insurance company is one of the best-governed companies in the country. So then, strategies in respect of ensuring our governance framework are part and parcel of our KPI management and when it comes to the presentation of the integrated reporting obviously, the governance becomes a key element. For example, look at our report we have a very high attention on governance framework, the governance reporting and how to establish further governance practices while doing our sustainable model. (IRP 18)

Further, the IAR of People's Leasing & Finance PLC (2016/17) illustrates some of the matters that the organisation considers material within the company's social and relationship capital, and that the company considers these matters as material since those actions are needed to achieve strategic objectives (see Figure 5).



Figure 5: Social and Relationship Capital (Source: People's Leasing & Finance PLC, 2016/17, p. 108)

People's Leasing & Finance PLC (2016/17) identifies: enhancing the brand position in untapped markets, consistent maintenance and improvement of international ratings, optimising group synergies and nurturing a knowledge culture within the organisation, as some of the important strategic aspects to stakeholders as well as to the organisation. These factors are identified as material matters by considering the strategic importance of the items. The company presents some of the identified strategic priorities, their current level of achievement, the expected level of achievement within the next three years, and the related strategies. Therefore, from the IR preparers' view, the meaning of materiality corresponds with the company strategy which requires integrated thinking.

Another important consideration is that while materiality links with performance measures; un-measurable items do not identify as material matters. An interviewee described how materiality links with KPIs to ensure the measurability of non-financial information:

Materiality comes with KPIs because we need to measure the performance of each and every element that we take into consideration. It's kind of a performance measure that we are always looking at because if you are thinking about any particular thing if it cannot be measured properly, it won't be a material issue. (IRP 12)

Our findings are consistent with the findings of Lai *et al.*'s (2017) study that found strategy determines IR materiality content. Lai *et al.* (2017) consider that materiality in the IR is inextricably linked to strategy, and the integrated report is conceived of as an instrument for communicating corporate strategy, as it cascades across the group. Our findings further expand Lai *et al.*'s finding by linking the strategy and materiality determination into integrated thinking which suggests that various activities and sections of an organization are considered as

connected rather than being separated into silos (Mio, 2016; Ratti, 2013) which can be essential for value creation (Busco *et al.*, 2013). The extent to which integrated thinking underpins the materiality determination process, and is linked to board and management discussions, is also important (IIRC, 2015). The preparers in this study assigned a pertinent function to the IR and aligned the definition of materiality with their business strategy. Thus, by giving materiality a strategy meaning, they satisfy the information demands of investors and stakeholders in the rapidly changing world. In addition, their IARs can satisfy the important need expressed by the board to reveal achievements from their companies' strategy.

6.3.3 Judgement and benchmarking

Judgement and benchmarking techniques are also used by the preparers to support their selection of material matters to report in their IARs. There is no precise approach to materiality determination (IIRC, 2015) and judgement is applied in determining materiality in IR (IIRC and American Institute of Certified Public Accountants, 2013). The materiality threshold for inclusion in the integrated report demands an exercise of judgment to separate the "material" from the "immaterial" (Eccles and Krzus, 2014). Interviewees from most of the sample companies pointed out the use of judgment in making the materiality determination. For example, one interviewee comments:

We decide ok this incident is not the average, this is beyond, so, we should report. That is a judgmental thing. (IRP 35).

Non-financial information is actually judgmental. To do that you have to have a very good idea about the company operations. (IRP 47)

However, no decision involving the use of accounting information can be made in a vacuum or by the consideration of a single variable. There appears to be the need for some sort of guide to support 'judgement'. In one company, a sustainability committee responsible for making judgments on materiality decisions uses a mapping system to determine the material matters:

There is a mapping system. Once you do this mapping, there is no guideline that is needed. We have something called a sustainability committee. The sustainability committee has nothing other than making these judgments. You need some judgments when you plot it on this map. So, this sustainability committee is the one that is making the judgment (IRP 13).

However, the undefined concept of professional judgment in materiality determination for non-financial information can only result in a proliferation of loose standards and practices. Loose practice may undermine confidence in the IR. This is especially so when the presentation of non-financial information shows a substantial lack of uniformity. The extant literature indicates that there may be no easy rule to follow to determine materiality (Eccles and Krzus, 2014). There is no rule prescribing the frequency or a precise approach to the materiality determination process (IIRC, 2015). A factor's relevance must be weighted by its importance to the company. Judgment is applied in determining materiality (IIRC and American Institute of Certified Public Accountants, 2013). The literature and interview findings indicate that the dilemma posed by considerations of materiality in accounting, including materiality in IR, is not a simple one. Good judgment must receive guidance from clearly formulated standards and limits. The debate regarding which criteria are applied is useless if the resulting practice produces a great diversity of results under similar conditions. However, benchmarking against other companies in the industry can provide some informal guidance.

Competition is high among companies in Sri Lanka. Competition is identified in the literature as a reason for companies to adopt IR (McNally *et al.*, 2017). Wild and van Staden (2013) found mimetic isomorphism as one factor driving the early uptake of IR by firms in the financial services industry. Companies wish to follow best practices within their industry, and so adopt mimetic processes whereby the preparers copy the “best practice” strategies of other successful organisations or competitors (Jensen and Berg, 2012). In addition, companies may try to copy or improve upon other organisations’ best practices in order to obtain a competitive advantage in terms of “legitimacy”. Interviewees from most of the sample companies mentioned one reason to adopt IR principles is competition or competitor pressure.

We wanted to be competitive in our reporting as well. It's really competitive in Sri Lanka and everyone wants to present the best annual report. It's not just the competition, it shows transparency, and the annual report reflects our transparency. So, winning an annual report award for IR reflects how transparent we are in the reporting process. We don't want to lose that position in the industry and, in order to secure our position, we need to adopt the current trends. We need to follow current trends, that is, IR principles (IRP 46).

Mimetic isomorphism is also observed to stem from the desire to follow best practice. The sample companies were influenced to adopt IR by national and international trends. Preparers also considered that best practices can be used to maintain corporate legitimacy and to obtain further competitive advantage.

It was the trend and we have to adopt good practices, global practices. That is our priority, and the main reason for us to go for IR and practice IR principles. (IRP 51)

A company can use information reported by other organisations, preferably from the same industry. By looking at the information reported by other companies, some companies ascertain some measures of an acceptable level of materiality. Preparers reported how they use benchmarking to determine materiality levels:

What we always do is we compare with our competitors and other good reports internationally and from those reports, we identify what they reported. We decide materially based on other reports actually. For example, we refer to South African good integrated reports. (IRP 47)

With a lack of guidance, organisations tend to copy the reporting strategies of their peers in the industries they operate in (Robertson and Samy, 2015). Thus, it is observed that the companies turned to other companies, in the same industry to benchmark their techniques and reporting practices. Our findings reveal that benchmarking is not limited to companies in the same industry. Preparers used ‘good’ IARs in any industry, locally and globally. They actively searched for different techniques to support their materiality decisions. This use of benchmarking adds new empirical findings to the IR materiality literature.

7. Concluding remarks and contributions

This study explored the challenges and techniques used by IR preparers to determine materiality levels. The IIRC anticipated that an emphasis on material matters would improve the quality of reporting and so enable more efficient and productive allocation of capital. It also expects enhancements in internal and external decision-making. This study finds that materiality determination is complex because much of the non-financial information is unable to be quantified, and there is a need to identify the various intended report users and their decision-making needs. This requires a balancing act between the various internal and external stakeholders of an organisation. The findings provide evidence that IR companies employ different techniques to determine materiality levels based on stakeholder analysis, usefulness

of information for decision-making, impact on stakeholders, value creation, relationship with strategy/KPIs, judgments, benchmarking, and varying combinations of techniques.

According to Churet and Eccles (2014), IR is only the tip of the iceberg, the visible part of what is happening below the surface, namely “integrated thinking” and “integrated decision-making”. The IIRF identifies the importance of integrated thinking and its relationship to IR: “Integrated thinking is the active consideration by an organisation of the relationships between its various operating and functional units and the capitals that the organisation uses or affects” (IIRC, 2013e, p. 2). It is evident from the interviews and the archival IARs, that most companies use a combination of techniques to determine the materiality levels for non-financial information. The findings showed varying combinations which included: (i) investor requirements/ stakeholder analysis and relationship with strategy and KPIs linked with strategy; (ii) investor requirements/ stakeholder analysis and judgment; (iii) investor requirements/ stakeholder analysis, usefulness of information for decisions and impact on stakeholders; (iv) value addition/creation and judgment; (v) value addition/creation, investor requirements/ stakeholder analysis, judgment and impact on stakeholders; (vi) value addition/creation, usefulness of information for decisions, judgment and impact on stakeholders; and (vii) judgment and benchmarking. In some instances, preparers used a combination of two or more techniques in their materiality level determination process. These methods are consistent with the IIRC criterion on materiality determination for non-financial information for identification and reporting of items that “substantively influence the assessments of the primary intended report users with regard to the organisation’s ability to create value over the short, medium and long-term” (IIRC, 2013d, p. 21). Cerbone and Maroun (2020) found that materiality becomes an amalgamation of the factors which are important for shareholders and other stakeholders. However, Cerbone and Maroun (2020) do not explain the factors used in this combination.

In the context of IR, the materiality assessment of non-financials are seen as being more difficult to apply than in financials. A few interviewees indicated that both IIRC and GRI guidelines are used to determine materiality levels for non-financial information. By contrast, most of the sample companies use the GRI guidelines to determine materiality levels for non-financial information in their IARs. The reason could be difficulties in establishing materiality for traditionally ‘non-financial’ factors (ACCA, 2012), as well as the availability of less guidance and experience on assessing materiality in the IR context (Hanks, 2012). Some interviewees suggested the idea of a regulatory framework for determining materiality levels in an IR context. Although materiality represents a ‘starting point’ for the IR preparation process (PwC, 2015a), the use of GRI guidance by most of the sample organisations to determine the materiality of non-financial information may hinder the expected benefits of IR anticipated by the IIRC. This could be one of the reasons for the increased length of the perused sample companies’ IARs and their deviation from the conciseness principle. The archival research findings provided very ‘Low’ or ‘No improvement’ rankings to the areas of conciseness, improved performance monitoring and process improvements in IR disclosures.

The findings indicate value additions in capital and value added to society as various dimensions of materiality where IR is identified as ‘value taken’ and ‘value given’ as the actions of an organisation interact with the world around it; i.e. not in a vacuum. The lack of guidelines and standards or a broadly accepted approach to materiality in IR hinders comparison and benchmarking and creates uncertainty for those seeking to understand this new approach of non-financial disclosures. Consequently, the diversity in materiality reporting practices may undermine confidence in IR; especially so because the presentation of non-financial information and the assessment procedures followed is not uniform. Preparers in this study indicate that they should be provided a ‘regulatory framework’ to help them determine materiality levels for non-financial disclosures in IR.

Some unintended consequences, causing deviation from the IIRC's objectives for IR, were observed. For instance, most preparers indicated the use of their IARs as an image building reputational tool. Preparers also tended to use GRI guidance, in preference to the IIRF, to determine the materiality of non-financial information. However, the GRI guidelines were not developed for use with IR, which is more focused on value creation and investors. This finding is important for regulators and policy makers who encourage IR practicing companies to use IIRC materiality guidelines for their materiality decisions. Further, since the length of most of the sample companies' IARs has increased, the materiality determination process does not appear to support the conciseness principle in the IIRF. Some of the IARs we examined included seemingly unnecessary and unimportant information, potentially indicating inappropriate use of the materiality assessment process. Apparently, problems around information overload and obfuscation of core issues have not been overcome with the adoption of IR in these companies.

This paper makes several theoretical, methodological, empirical and practical contributions. By way of a theoretical contribution, this study provided further evidence that all three types of isomorphic forces individually and collectively influenced the adoption of IR materiality procedures. The interviewees experienced coercive isomorphism pressures stemming from the IIRC, other IR-supporting organisations and shareholders. Stakeholders and their preference for integrated reports provided additional coercive pressure. Interviewees also appeared to copy (mimetic isomorphism) competitors and other IR-adopting organisations. CASL and the four large accounting firms in Sri Lanka all exerted normative isomorphism pressure on the sample companies to practice materiality in IR.

The paper used the exploratory interpretive method to explain how the IR phenomenon was socially understood and constructed by the interviewees. There is a paucity of empirical research on IR materiality level determination, which this paper addresses by extending the exploration of challenges and techniques used to determine materiality levels. For example, we identify the usefulness of information for decision-making, and the impact on stakeholders as criteria, which have not been mentioned in the prior literature. The literature is silent on how organisations relate materiality to value creation for the purposes of determining the materiality content of an integrated report. This research provides empirical evidence of the use of value creation criteria in materiality determination. Materiality is a combination of efforts where everyone in the organization is involved and that strategy should be linked in IR. Preparers indicated that integrated thinking, which relates to connectedness, is required for materiality determination.

The findings of this paper contribute to the work of regulators such as the IIRC and CASL, who may be considering revising its IR guidelines and framework for materiality determination. The findings of materiality level determination provides useful insights to the IIRC and CASL in their planning for a review of existing IR non-financial materiality guidelines. Countries where IR has not yet been adopted, or not fully implemented, could benefit from the findings of this study. In addition, regulators can understand companies' requirements and needs for specific guidelines and plan training and other supportive programmes relating to materiality determination. The IIRC and other regulators, such as stock exchanges and regulators tasked with investor protection, may be interested to read that preparers have to manage the challenges of materiality determination by considering the positive impact of such disclosures to obtain competitive advantage. The use of a competitive edge strategy as a determinant for materiality level decisions is a new finding in the IR literature. However, the findings also highlights the potentially problematic issue of the use of materiality in IR as an image building reputation tool. Regulators will therefore be interested in the impediments to materiality level determination and the techniques being used by IR preparers as a brand enhancing tool, which implies weak accountability and a less than desirable response

toward stakeholders demand for more decision-useful disclosures. The results of this study will also be of interest to preparers and consultants providing solutions to issues of materiality determination and considering techniques to use to determine which non-financial information to disclose in integrated reports, and for new companies planning to adopt IR. Researchers may also use the findings to develop their understanding of the core challenges with regards to IR materiality and the interdependencies between materiality and integrated thinking through further future research avenues.

As with all research, this study has its limitations and therefore its results should be interpreted carefully. We interviewed a significant number of IR preparers in a variety of roles in their companies. These IR preparers were intentionally selected from the companies listed in the Sri Lankan stock exchange market and comparatively, in a global sense, may not be particularly large in size. These preparers were also part of the early adopters and their IR experience may not have been extensive. However, the results of this study are still useful to countries that are still developing and are considering the adoption of IR. The experiences of our IR preparers suggest that in order for companies to fully engage in integrated thinking in the preparation of integrated reports that demonstrates strong accountability and transparency, more hands-on support and guideline need to be provided by relevant parties. Madison and Schiehl (2021) found in the case of ESG disclosures that “innovations in accounting standardization practices, such as the SASB standards, offer useful guides to help researchers and practitioners prepare more relevant ESG disclosures” (p. 19). Our findings suggest that there is also such a request for guides to help IR preparers prepare better materiality disclosures in integrated reports. However, can there be standardisation in IR given that the main benefit of IR is its adaptability to different organisations, industries and countries? According to Guillot and Tilley (2021), “in the future, SASB Standards will likely evolve to ensure businesses can provide metrics and data on all of the five capitals to drive robust reporting” (para.14) and that over time, there is the plan to merge the IIRF’s capitals and the SASB’s sustainability dimensions to build a common comprehensive architecture for reporting.

Future research could use a questionnaire survey, covering a larger number of companies, a broader range of industries and countries. Future research on different stakeholder perspectives on material information in IR could also contribute to our understanding of the concept given the new directions being set by IIRC and SASB. Further, the action research method where researchers spend time with IR preparers could provide further insights into the complexities of preparing integrated reports and determining materiality in IR.

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