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Governance Disclosures According to IIRC's Integrated Reporting Framework

-Are Annual Reports of Swedish Listed Companies in Line with the Framework?

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Abstract

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Background and problem - Integrated reporting is a hot topic today and is predicted to be the future of companies' external reporting. In December 2013 a new framework on integrated reporting was released and one part of the framework concerns governance and how it supports the organization's value creation. A recent study on integrated reporting in Sweden showed the area of governance to be poorly reported. However, no previous study in Sweden has examined the current state of governance disclosures compared to the <IR> framework in depth. This is important in order to find good examples of reporting to further enhance the development of integrated reporting.

Purpose - This thesis aims to assess the extent to which Swedish listed companies comply with the guidelines in the <IR> framework's content element governance using a self-constructed scoring system. Furthermore, the aim is to analyze the possible relationship between the results and the size of the company.

Methodology - The purpose was fulfilled through an analysis of 21 annual reports of Swedish listed companies, seven from each segment on the OMX Nordic Stockholm, i.e. large, mid, and small cap. The annual reports were assessed using a self-constructed scoring system primarily based on the <IR> framework's content element governance.

Analysis and conclusions - The study found that the majority of the companies at least mention most of the aspects included in the <IR> framework. However, the average annual report needs large improvements before it can be claimed to be in line with the <IR> framework regarding the area of governance. Furthermore, the study found a relationship between the result of the study and the size of the company, meaning larger firms were more in line with the <IR> framework's content element governance.

Keywords - Integrated reporting, Corporate governance, Voluntary disclosures, Stakeholder theory, Legitimacy theory, Information asymmetry, Capital market transactions hypothesis, Agency theory, Self-constructed scoring system, Company size.



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1. Introduction

Integrated reporting is a hot topic in the accounting, audit, and advisory sector and is predicted by many to be the future of corporate reporting. A new framework on integrated reporting was published in December 2013 (IIRC 2014a). This thesis will focus on the area of governance within integrated reporting and on the extent to which today's annual reports of Swedish listed companies meet the guidelines of integrated reporting regarding governance. The four headlines below are from the last months and highlight the importance and timeliness of integrated reporting.

“Integrated reporting – a new way to communicate” (Rimér 2013, article published on FAR’s website, own translation)

“A report for the 21st century” (Lennartsson 2014, article published in Balans, own translation)

“A better way for corporate transparency and accountability” (Jafar 2014, article published in The National)

“Integrated reporting – a Swedish competitive advantage” (Lennartsson 2013, article published in Balans, own translation)

The first headline above is from an article summing up a lecture on integrated reporting held at Finforum, a conference in Sweden for CFOs, analysts, and accountants addressing listed companies' communication with the market (FarAkademi 2014). The article asserts the importance of integrated reporting, i.e. to actually communicate what is being done, and informs about the new framework from the International integrated reporting council (IIRC) (Rimér 2013).

The article with the headline *“A report for the 21st century”* is an interview with Göran Tidström, the former accountant and president of the European and international federation for accountants. Tidström talks about the fast and enthusiastic development of the new integrated reporting framework as well as the great interest it has received from a global and broad audience. Integrated reporting, Tidström argues, is not only a tool to improve the communication with the stakeholders; it is also a tool to improve the companies' actions and the entire business model. (Lennartsson 2014)

“A better way for corporate transparency and accountability” is a headline found in the newspaper The National from the United Arab Emirates for an article that discusses the need for companies in the Arabian Gulf to be more transparent as a response to globalization. Globalization has further led to a complex reporting with many jurisdictions and stakeholders to satisfy. Therefore, as explained in the article, several Gulf companies have started to produce the more concise report called an integrated report. (Jafar 2014)

The article behind the fourth headline argues that Swedish companies are likely to be faster at adapting to the integrated reporting framework than other countries since Swedish companies generally are far ahead in the sustainability questions (Lennartsson 2013).

1.1 Background

On the 9th of December 2013 the International integrated reporting council (IIRC) released the international integrated reporting (<IR>) framework (IIRC 2014a). IIRC is a global organization representing companies, standard setters, regulators, the accounting profession, investors, and Non-Governmental Organizations (IIRC 2014b). They have been working on the framework for integrated reports since their establishment in 2009 (IIRC 2014c). A company’s integrated report should explain how the business activities work and affect the outside world (Lennartsson, 2014), and the main purpose of the report is to inform stakeholders of how the organization creates value over time (IIRC 2013b). The <IR> framework defines value creation as increases, decreases or transformation of capitals. These capitals are, according to the <IR> framework, resources and relationships used and affected by an organization (IIRC 2013b).

A publication by KPMG (2012) argues that the stakeholders of today demand a more holistic picture of the company with its value creation and a long-term view portrayed in the annual reports. This demand is, according to this publication, not fulfilled today. The demand is partly caused by the changing context in which companies operate and an increasing awareness among stakeholders that there is a correlation between sustainability and financial performance (PwC 2013c). Meeting the stakeholders’ demand for a more holistic picture by adding additional reports, included in or separate from the annual report, covering environmental and social performance, intellectual capital or governance, does not necessarily explain how these aspects affect each other (Abeysekera 2013). Increased quantity of information is therefore not necessarily the solution.

What the IIRC is trying to accomplish with the framework is for the companies to display how they link their strategy, financial performance and governance with the social, environmental as well as the economic context in which they function (A4S 2014). By doing so, the report

will describe the company and its value creation process in a clear and concise way (IIRC 2011). Thus, integrated reporting is said to minimize the gap between what stakeholders demand and what companies provide (KPMG 2012).

Swedish companies are not obligated by law to follow the <IR> framework, since IIRC is neither a regulator nor a standard setter. However, companies can voluntarily choose to adopt the framework. Incentives for companies to voluntarily disclose include gaining legitimacy and reducing information asymmetry, capital cost, and agency problems. Thus, companies have an interest in fulfilling the stakeholders' demand for integrated reporting. In fact, the Swedish accounting sector and many Swedish companies welcome the new framework (Lennartsson 2013). Sweden has for a long time been a role model in the area of sustainability reporting (KPMG 2011) and one could think that Swedish companies should also be prominent regarding integrated reporting. Mikael Hagström, vice president and head of group financial reporting at Volvo, believes this is the case (Lennartsson 2013). A study conducted by the PwC (2013a) on the other hand shows that the studied companies on the NASDAQ OMX Stockholm (OMX 30) have room for improvement in several important areas of integrated reporting. The least well-reported area was, according to the study, governance.

Information on governance and the governance structure is of major importance in an integrated report. It adds credibility to the entire report and creates confidence in the company's ability to successfully implement the business model and execute the strategy (IIRC 2013c). The IIRC recognizes the importance of governance and includes it as one of the content elements of the <IR> framework. The integrated report should provide insight about how the governance structure supports the company's ability to create value in the short, medium, and long term (IIRC 2013b).

1.2 Problem discussion and thesis contribution

The motivation for this study was derived from (a) the positive effect integrated reporting is believed to have on minimizing the information gap between what stakeholders demand and what companies provide, (b) the importance of governance disclosure for the credibility of the annual report and for the confidence in the companies' ability to create value, and (c) the absence of previous studies analyzing annual reports' extent of compliance with the guidelines in the <IR> framework.

No previous study has used the guidelines in the recently released <IR> framework as the basis for an in-depth examination of Swedish listed companies' annual report. This study hereby contributes to the existing literature. Similar studies have, however, been conducted. Examples

include a recent study examining the similarities between annual reports and integrated reports, which found governance to be poorly disclosed (PwC 2013a). Other studies have focused on the quality of corporate governance reports, with various results (PwC 2013b). Thus, this thesis aims to construct a way to measure the state of governance disclosures compared to the guidelines in the <IR> framework in order to clarify the current state of Swedish listed companies' governance disclosures and contribute with examples of good reporting of governance. This may enhance the development of best practice, which is believed to be a way to facilitate the implementation of integrated reporting (Lennartsson 2013).

Furthermore, previous studies have mostly focused on the largest companies (for example PwC 2013a). Therefore, this thesis includes annual reports from all three segments on the OMX Nordic Stockholm, i.e. large, mid, and small cap. Through this it was possible to analyze whether larger companies are more in line with the <IR> framework's content element governance.

1.3 Purpose and research questions

This thesis aims to assess the extent to which Swedish listed companies comply with the guidelines in the <IR> framework's content element governance using a self-constructed scoring system. Furthermore, the aim is to analyze the possible relationship between the results and the size of the company.

The purpose can be broken down into the following research questions:

1. To what extent do Swedish listed companies meet the guidelines in the area of governance presented in the <IR> framework?
2. Can a relationship be seen between the extent of compliance with the <IR> framework's content element governance and the size of the company, and if so, what are the possible explanations behind this relationship?

1.4 Disposition

This thesis begins with a presentation of the *frame of reference*. In order to construct the scoring system information had to be gathered about for example integrated reporting, governance and the <IR> framework. Thus, the *methodology* is to a high degree based on the frame of reference and is therefore presented after the frame of reference. In the methodology section the way the study was carried out and the motivations for this are also presented. In the following chapter, *empirical results and analysis*, the findings from the study are described, as well as explanations for these findings and connections to theories. These two sections are presented together in order to avoid repetition. In the chapter *conclusions* the main findings are stated and

the research questions of the thesis are answered. This section also includes implications for further research. The conclusions are followed by a list of *references*. All the annual reports used in the study and referred to in the text are gathered at the end of the reference list to make them easier to find. Lastly the *appendices* are found including for example a thorough presentation of the scoring system and how to apply it.

2. Frame of reference

In this chapter background information on integrated reporting and governance is stated. Furthermore, the development and importance of integrated reporting and governance disclosures are outlined. In connection to this the Stakeholder theory, Legitimacy theory, Information asymmetry, Capital market transactions hypothesis, and the Agency theory are explained. The chapter ends with a presentation of the Global Reporting Initiative (GRI) and an outline of previous conclusions drawn about the relationship between voluntary disclosures and the size of the company.

2.1 What is integrated reporting?

“The two great challenges of the 21st century – financial stability and sustainability – are interconnected” (Mervyn King – IFC 2012, p. 1).

Integrated reporting is believed by many to be the way of combining these two essential areas, financial stability and sustainability, and a way to reach the overall goal of a sustainable society (IIRC 2013b; Eccles & Krzus 2010). Sustainability, in its broadest definition, addresses how actions of today impact the available choices of tomorrow (Crowther 2002). If unsustainable, the way business is done in the present will be more costly, or even impossible, in the future due to the decreased availability of needed resources. Sustainability therefore stresses that resources are consumed in line with the pace of regeneration (Aras & Crowther 2008).

Integrated reporting is the result of a market-led demand on corporate reporting to be more transparent, concise and accountable. Stakeholders, particularly investors, demand more information than what can be found in the backward-focused financial reports (IIRC 2011; KPMG 2012). An integrated report is a report where an organization informs of how it creates value (IIRC 2014b). It links the information on strategy, performance, future outlook, and governance in one concise message, enabling the reader to assess how the organization creates and sustains value, not only short-term (IIRC 2014b; IIRC 2011). This is crucial to communicate particularly since some resources utilized by companies are finite in quantity and will therefore not be available in the future unless actions are taken to prevent this. Without such actions the company itself is not sustainable. Today’s corporate reporting is often blamed for failing to communicate this linkage and one reason is the development of presenting non-financial information¹ in a separate report with no connection to the rest of the report (Eccles & Krzus 2010).

¹ Non-financial information is a widely used term with several definitions. According to Eccles & Krzus (2010), non-financial information includes intangible assets, Key Performance Indicators and, information on environmental, social and governance issues.

The integrated report is anticipated by the IIRC (2011) to be the primary report for companies, a supplement rather than a complement to existing reports. This means including mandatory and voluntary information but with *materiality*² as guidance in order to reduce clutter. However, the report should contain clear references to more detailed information, for instance online, to enable users to further explore different issues (Eccles & Krzus 2010).

2.1.1 IIRC

The International Integrated Reporting Council (IIRC) was established in 2009 (IIRC 2014c) and consists of regulators, investors, companies, standard setters, the accounting profession, and Non-Governmental Organizations (IIRC 2013b). The board includes Mervyn King (IIRC 2014g), who is sometimes referred to as the Doyen for corporate governance (EY 2014). From the start the aim of the IIRC has been to create a globally accepted framework on integrated reporting in order to reach the long-term vision of introducing and embedding integrated thinking into the business (IIRC 2014d). Integrated thinking is a prerequisite for enabling integrated decision-making that considers value creation in the short, medium and long term (IIRC 2013b).

2.1.2 The <IR> framework

As a first step towards the <IR> framework a discussion paper outlining integrated reporting was released in September 2011 (IIRC 2011; IIRC 2014e). In April 2013 the consultation draft was presented, followed by three months of global consultation and submission of 359 comments to the IIRC from organizations representing all regions of the world and a variety of sectors (IIRC 2014h). On December 9th 2013 the <IR> framework was released (IIRC 2014a). Companies are not obligated by law to follow the framework, instead it is a guide towards adopting integrated reporting, meaning making the reporting more efficient and focused on value creation, leading to better reader understanding, better capital allocation and a more sustainable economy (IIRC 2014a). The implementation of integrated reporting is therefore benefiting both business and investors (IIRC 2014i).

The framework consists of seven guiding principles: Strategic focus and future orientation, Connectivity of information, Stakeholder relationship, Materiality, Conciseness, Reliability and Completeness, and Consistency and Comparability that should permeate the process and presentation of the integrated report (IIRC 2013b). Additionally, there are eight content elements: Organizational overview and External environment, Governance, Business model,

² The <IR> framework defines materiality as a matter that could substantively affect the organization's ability to create value in the short, medium or long term (IIRC 2013b p.33).

Risks and Opportunities, Strategy and Resource allocation, Performance, Outlook, and Basis of preparation and presentation that should be included in the report. Each content element begins with a question in bold italic and all these questions should be answered in order to call the report an integrated report according to the <IR> framework (IIRC 2013b). For the content element governance the question is *“How does the organization’s governance structure support its ability to create value in the short, medium and long term?”* (IIRC 2013b p. 25). The question is followed by guidelines, which assist the user in answering the question. Throughout the framework it is stressed that the integrated report should explain how the organization creates value in the short, medium and long term (IIRC 2013b).

2.1.3 Value creation

While the meaning of value traditionally has been connected to changes in financial capital due to financial performance, IIRC (2013a) points out that value and value creation is dependent on a broader range of factors, both tangible and intangible. Value itself cannot be defined since the meaning of it is different for different people in different contexts (IIRC 2013c) and managers need to find and understand their company’s specific key drivers of value (Marr et al. 2004). What is possible to define, however, is the process of *value creation* even though there is no universally agreed definition of value creation or how it should be communicated.

The IIRC (2013c p. 1) defines the process of value creation in its background paper as follows: *“Value is created through an organization’s business model, which takes inputs from the capitals and transforms them through business activities and interactions to produce outputs and outcomes that, over the short, medium and long term, create or destroy value for the organization, its stakeholders, society and the environment.”*

The definition highlights that value creation should be recognized as a wider term than for the company only, meaning that when a company defines what value is for them they must also consider if value is created or destroyed for society at large. Porter and Kramer (2011) refer to it as *shared value*. The authors state that ignoring social needs will create internal costs for the company and eventually make it unsustainable. Thus the ability for the company to create value for itself is dependent on the value that is created for others.

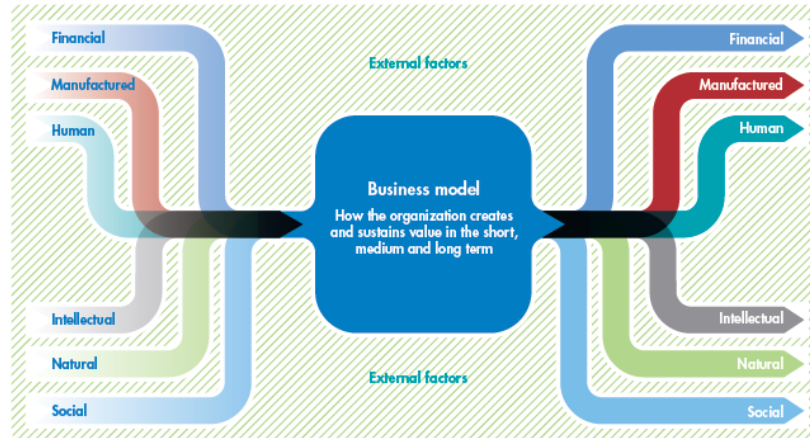


Figure 1 The business model (IIRC 2011, p. 10)

IIRC's definition also states that the business model is the central vehicle in the value creation process and vital for how the company's capitals are being managed. Figure 1 is taken from IIRC's discussion paper and shows their interpretation of a business model. The capitals refer to the resources and relationships used and affected by the company and include financial, human, manufactured, intellectual, social and relationship, as well as natural capitals (IIRC 2013b). The communication to stakeholders regarding these capitals and how the business model manages them is crucial for the level of confidence in the company's value creation process. What is also important for the confidence is information regarding the governance structure since the structure has significant impact on a successful implementation of the business model (IIRC 2013c). Governance reporting is thereby of great interest to stakeholders since it provides insight in the company's ability to create and sustain value (PwC 2013d; IIRC 2013c).

2.2 What is governance?

Governance means steering and is necessary in all listed companies. The focus of this study is corporate governance and involves the structure necessary to monitor the company in the right direction (Kanagaretnam et al. 2007; Haniffa & Hudaib 2006; Cadbury report 1992). Corporate governance has been defined by Denis and McConnell (2003) as mechanisms that induce managers of the company to work in line with the interest of the owners, thereby maximizing the value for the owners. These governance mechanisms can broadly be divided into two groups: external and internal. External mechanisms include for example the legal system (Denis & McConnell 2003). Examples of the internal mechanisms of governance, which are the focus of this thesis, include board structure variables (Haniffa & Hudaib 2006), incentive schemes (Donaldson & Davis 1991), the decision-making process, and the implementation of decisions taken (Abeysekera 2013).

In many organizations, especially public companies, where ownership and management are separated, the *responsibility* of the in-firm governance is given to the board of directors (Cadbury Report 1992). IIRC's <IR> framework (2013b p. 33) defines *those charged with governance* as follows: “*The person(s) or organization(s) (e.g., the board of directors or a corporate trustee) with responsibility for overseeing the strategic direction of an organization and its obligations with respect to accountability and stewardship.*”

The theoretical approach to corporate governance can be derived from the *agency theory* (Jensen & Meckling 1976; Eisenhardt 1989), which highlights the possibility of conflicts of interest between management of the firm and the shareholders of the firm when these positions are separated (Tariq & Abbas 2013). Furthermore, the agency theory has also been developed to include all stakeholders in the *stakeholder-agency theory* (Hill & Jones 1992). Similar to shareholders all type of stakeholders, for example customers, suppliers, and the society, have an interest in knowing that the company is in line with the interest of the stakeholders. The agency theory, therefore, suggests the implementation of a system with internal and external control mechanisms that direct and control the company (Tariq & Abbas 2013) and these control mechanisms are, as explained above, known as corporate governance (Haniffa & Hudaib 2006; Cadbury report 1992).

When steering the company the board is responsible for making sure the interests of the managers are in line with those of the stakeholders (Frías-Aceituno et al. 2013), i.e. minimizing the agency problems by ensuring the business activities are congruent with the company's strategy and that the management and employees know what to do and are capable of executing the strategy (Solomon 2010). Some definitions include management as part of those charged with governance, on the grounds that to be effective governance direction and control must exist throughout the company (Bloomfield 2013). This thesis defines those charged with governance in line with IIRC's definition as the board of directors, which is also supported by others (Cadbury report 1992; Kollegiet 2010). In addition, the way the board of directors governs the company may in many cases include directing the management.

2.3 The evolution towards integrated reporting

Both the nature and the content of corporate reporting have changed. Historically, corporate reporting consisted of past financial information (Eccles & Krzus 2010), which basically just informed about profit and losses, assets and liabilities (A4S 2014). These financial reports were mainly addressing firms' shareholders (Crowther 2002). While financial reporting goes back hundreds of years, matters of non-financial reporting only have a few decades of history

(Larsson 2009). In the 1970s, corporate reporting was extended to cover social aspects and, in the late 1980s and early 1990s, environmental reporting evolved as a consequence of several accidents and disasters such as Chernobyl and Bhopal (Herzig & Schaltegger 2006).

Today, a majority of the largest listed companies present a sustainability report (KPMG 2011), often with both social and environmental aspects combined. The amount of integrated reports are still limited but on the rise. South Africa is prominent in this area and, since 2010, the organizations listed on the Johannesburg stock exchange are required to present an integrated report (Integrated Reporting Committee of South Africa 2011). While financial reporting is mandatory for listed companies in Sweden, non-financial reporting is still mostly an unregulated area. Companies presenting information other than strictly financial mostly do it on a voluntary basis. Likewise the choice of producing an integrated report is voluntary. Below, major factors behind the development towards integrated reporting and why companies choose to be more transparent in their reporting than required by law are mapped. The reasons behind voluntary disclosures are numerous and extensive. Therefore, the main reasons behind this development are examined below.

2.4 External drivers of change

Since no company operates in isolation, the external environment has an impact on all organizations (Eccles & Krzus 2010). The society has for instance shifted towards a more knowledge-based economy (Lev & Daum 2004), where companies' value creating assets are to a higher extent intangible³ (Eccles & Krzus 2010; IIRC 2013c). However, few of these are shown on the balance sheet (Eccles & Krzus 2010), which makes the importance of non-financial reporting apparent since a true and fair view of the company cannot be displayed without this information (Krstić & Đorđević 2010).

Globalization, rapid population growth, and increasing global consumption are other drivers of change and these are affecting the quality, price and above all the availability of resources (IIRC 2011). This is closely linked to the well-established fact that planet earth is suffering due to pollution and the degradation of ecosystems. The result is an increasing awareness among stakeholders that to remain sustainable, companies must take these aspects into consideration. This is supported by Eccles, Krzus and Serafeim (2011) who state that the market's interest in non-financial information, especially environmental information, is growing.

³ Intangible assets include for example: employees' competency, relationships, reputation and, the effectiveness of the organizations' structure, production and, processes (Allee 2008).

According to the same authors, governance information, particularly board composition and board activity, is also of great interest to the market. The demand on businesses to include more information specifically on corporate governance as well as risk management and scenario planning (PwC 2011) partly has its foundation in the global financial crisis of 2008/2009, which resulted in a crisis of trust (Eccles & Krzus 2010). Two contributing factors to the crisis were the companies' dominated short-term focus and a lack of long-term perspective in decision-making (IIRC 2011). To avoid a recurrence of the crisis the solution is more corporate transparency (Jones & Thompson 2012; Eccles & Krzus 2010) since transparency helps build trust (IIRC 2011). One way is to inform about how the business of the companies performs and is governed in the light of these risk issues (PwC 2013c; PwC 2013b).

The move towards more disclosures of non-financial information has been accompanied by numerous standards, principles and guidelines (Frías-Aceituno et al. 2014). Parallel to this development, the regulation regarding financial information has tightened and become more complex. Accounting standards of today are often difficult to interpret and companies are required to spend a lot of time and resources to produce their financial statements (Eccles & Krzus 2010). One major reason behind the more complex accounting standards is the growing financial market, which has resulted in advanced financial instruments including for example derivatives, hedges, swaps, securitizations and stock options (Eccles & Krzus 2010). The outcome includes an increase in the amount of information provided in the annual reports, but more information also makes it hard to use and understand. The growing amount of information in the annual reports is also due to the regulation regarding governance and governance disclosures, which is examined further below. Integrated reporting aims to increase the understandability of corporate reporting and make it concise, meaning decreasing the amount of information necessary for stakeholders when assessing the company (IIRC 2011).

2.5 Internal drivers of change

Although organizations are clearly affected by their external environment, major questions to answer are *to whom* they adapt and *why*?

2.5.1 To whom do companies adapt?

The stakeholder theory can be seen as one background factor for the development towards more non-financial disclosures. The *Stakeholder theory* was first presented by Freeman in 1984. The theory defines stakeholders as groups and individuals that affect or are affected by the organization, for example providers of capital, customers, suppliers, and communities (Freeman et al. 2010). The theory diverges from Friedman's *Shareholder value theory*, which argues that a firm's primary purpose is to maximize the value for shareholders and actions by

the firm should not be taken unless they generate profit (IIRC 2013c). The stakeholder theory, on the other hand, does not favor a particular group or individual since an organization interacts with and has obligations to various actors in society, not just their shareholders (Freeman et al. 2010).

Thus, the management of firms must keep the relationships with the different stakeholders in balance, otherwise the existence of the firm is threatened (Freeman 2001). The organizations will therefore make sure that the demand of those stakeholders that control vital resources are met (Deegan 2007), meaning both managing the effects of the business activities and producing external communication to the stakeholders (Herzig & Schaltegger 2006). As a result of organizations considering a wider group of stakeholders and a rising awareness and a growing demand for information among these stakeholders, the communication presented by the organizations has changed.

2.5.2 Why do companies adapt?

As mentioned above environmental reporting evolved as a consequence of several accidents and disasters such as Chernobyl and Bhopal. Companies were believed to be the major cause of environmental problems and as a consequence organizations started to inform about relevant activities related to the environment (Herzig & Schaltegger 2006). This phenomenon can be explained by the legitimacy theory, a theory on why companies choose to publish voluntary disclosures (Deegan 2007). The theory concludes that companies voluntarily disclose in order to legitimize themselves (Michelon & Parbonetti 2012; Cho & Patten 2007), meaning persuading the stakeholders that their interests are congruent with those of the company and are cared for and taken into account when forming the company's strategy. This condition is called legitimacy (Lindblom 1994, see Wilmshurst & Frost 2000 p. 23) and is seen as a resource for the company (Mahadeo et al. 2011; Tilling & Tilt 2010). The effect of preserving legitimacy include gained support from society, in terms of for instance increased capital inflow, customer appreciation and labor participation (Mahadeo et al. 2011).

Other incentives for the companies to produce voluntary disclosures include reduced information asymmetry and agency problems (Mallin & Ow-Yong 2012). Agency problems will be explained under the development of corporate governance reporting. The people in the company, the ones actually performing the business activities, have more information on how the activities affect the surrounding world than external stakeholders (Schaltegger 1997). This is called information asymmetry. The Nobel Prize winner Akerlof (1970) explains the outcomes of information asymmetry in his market for lemons theory. Products that are of good quality are driven out of the market by worse products if there is no information. This phenomenon is

known as adverse selection due to information asymmetry (Akerlof 1970). As the buyer cannot assess the quality of the product without information, he/she will not pay the price it deserves (Healy & Palepu 2001). This is also argued to lead to ineffective capital allocation (Mallin & Ow-Yong 2012).

Companies can in the same manner communicate, through for example voluntary disclosures, in order to reduce investor uncertainty, providing information upon which valuations and decisions can be based (Meek et al. 1995). To exemplify, if an investor is choosing between two companies, he or she needs information in order to assess the companies. Without information, the unsustainable company A will look just as good as the sustainable B. B needs to convince the investor that his/her company is worth more than A. This can be done through corporate sustainability disclosures. The dilemma, however, is that A could produce dishonest information, forcing the investor to also assess the quality of the given information (Akerlof 1970). This is elaborated below in the section on the development of corporate governance reporting.

Since voluntary disclosures reduce information asymmetry, according to the *Capital market transactions hypothesis*, this motivates companies to produce voluntary disclosures as it reduces the cost of the firm's external financing (Healy & Palepu 2001).

2.6 Corporate governance reporting

As this thesis concentrates on the area of governance within integrated reporting the development and importance of corporate governance reporting are explained below.

2.6.1 Development of corporate governance reporting

Several corporate scandals and corporate governance failures in the 1990/2000s due to fraud and insufficient systems of control have raised the question of the credibility of corporations and particularly the governance (Tariq & Abbas 2013; Larsson 2009). The financial crisis contributed to an increase in focus on corporate governance, mainly effective risk management and reporting practices (Ntim et al. 2013). One effect is that governance codes have grown in quantity around the world in recent decades (Abbas & Tariq 2013). The Swedish governance code exists to maintain *good governance*, i.e. to secure that the company is governed in a way that is consistent with the idea of the shareholders (Kollegiet 2010), thus minimizing the risk of agency problems. The code is a complement to legislation and not mandatory for listed companies to follow (Kollegiet 2010). However, when deviation is made from the guidelines in the code the company must motivate why and present the alternative, which concludes that some sort of corporate governance report must be produced.

The current state of Swedish corporate governance reports is that they live up to the requirements in the code to a large extent, but they sometimes lack the necessary details (Kollegiet 2010). They also tend to be quite generic, and remain the same from year to year (Lagerström⁴; PwC 2013a), but lately a trend towards more integrated corporate governance reports has been noted (PwC 2013b). The report should not be seen as a burden, it is an instrument for improving the governance and communication to stakeholders (PwC 2013b).

The need for corporate governance reporting exists primarily in companies where the role of financier and manager are separated. The arguments for improved corporate governance reporting are supported by the agency theory and serve to reduce agency problems. Agency problems include the well-studied shareholders' risk of managers leading the company into unattractive projects, in order to for example serve their own interests (Schleifer & Vishny 1997). Good governance makes sure that the interests of the managers are in line with the owners, thereby the company is seen as less risky (Krafft et al. 2014) and investors are willing to pay a higher price (McKinsey 2002).

Agency problems are not limited to the relationship between the firm and its shareholders. The stakeholder-agency theory recognizes the difference of interests between the firm and all its stakeholders (Hill & Jones 1992). As pointed out above, corporate governance is needed as a channel between stakeholders and managers (Buck et al. 1998). According to King III⁵ (IoDSA 2009), the board is responsible for overseeing the management-stakeholder relationship. Corporate governance reporting has therefore been developed to assist stakeholders in the assessment of the quality of the governance, hopefully creating a feeling of trust towards those charged with governance.

2.6.2 Importance of corporate governance reporting

It can be concluded that stakeholders need information to make better decisions and that companies are favored by producing voluntary disclosures. Advantages include gained legitimacy and reduced information asymmetry and capital cost. In order to reach the advantages, however, the disclosures need to be credible (Akerlof 1970; Healy & Palepu 2001) and credibility is the most important capital of a company (Larsson 2009).

⁴ Bo Lagerström, partner and specialist in corporate reporting at PwC, telephone interview February 11th 2014.

⁵ King III is the short name for the King Code of Governance Principles and the King Report on Governance issued by IoDSA, the Institute of Directors in South Africa (IoDSA 2014). Those companies listed on the Johannesburg Stock Exchange are obligated to comply with the King III (Solomon & Maroun 2012).

The disclosures on governance structure affect the reader's view of the credibility of the entire set of disclosures, as it reflects the confidence of the company's ability to create value through the business model, be transparent and disclose accurate information (IIRC 2013c). A study done by Byard, Li and Weintrop (2006) concluded that governance quality is positively correlated with the quality of analyst forecasts, signaling that companies with high governance quality produce more reliable and transparent information. According to the Global Investor Opinion Survey, more than 50 % of Western European and North American investors even consider governance more, or equally, essential as financial issues: i.e. profit performance and growth potential (McKinsey 2002). In the rest of the world the number is over 80 %. Furthermore, it is the management that usually determines the extent of disclosures (Deegan 2007; Mallin & Ow-Yong 2012), and it is argued that the board has the role of monitoring the managers (Fama 1980). This further adds to the arguments that it is important to disclose information about the board and its actions.

2.7 The need for integrated reporting

One might ask why the existing financial reporting in combination with the increasing amount of non-financial information is not enough? Why is there still a gap between what companies communicate in their reports and what stakeholders want despite all the information available?

Integrated reporting is the result of an increasing, market-led demand on corporate reporting (IIRC 2014a) since the information in the backward-focused financial reports are not enough according to the stakeholders (IIRC 2011; KPMG 2012). Evolution has resulted in an increasing awareness that an organization's performance and value creation depends on a variety of factors that are not only financial but also non-financial factors, and thus not all shown on the balance sheet (1company 2013). The clear trend of today is to make more "Stakeholder-oriented reporting" and highlight factors such as sustainability and stakeholder commitment (Solomon & Maroun 2012). With a broader set of stakeholders recognized by the company, more information is disclosed voluntarily, on for example environmental and social issues (Hassan & Ibrahim 2012).

Despite the fact that the traditional financial reports now are accompanied by a greater number of sustainability reports and other non-financial information, major disclosure gaps between companies and their stakeholders still remain (KPMG 2012). The attempt of organizations to gain legitimacy, reduce information asymmetry, and fulfill the several regulations, standards, general demands, and expectations regarding corporate reporting have led to voluminous, cluttered, complex, and disconnected reports that often are hard to interpret (Abeysekera 2013; IIRC 2011). Adapting to the different frameworks in isolation does not automatically result in

an interconnected report (Abeysekera 2013). The non-financial information is often presented separately with no connection to the rest of the reports, which makes it hard for the user to make an appropriate assessment of the company, thereby not meeting the demand of the stakeholders after all. The disclosures need to be understandable in order to reach the advantages known to come from disclosing (Schaltegger 1997).

A new trend has therefore started to develop, where an integration of sustainability and governance information is asked for (Solomon & Maroun 2012; Herzig & Schaltegger 2006). Integrated reporting makes it easier for companies to concisely bring together the material information needed to communicate with stakeholders on how the company creates value in the short, medium and long term (IIRC 2011). Thus, the long-term perspective prevents organizations and investors from making impulsive, short-term decisions with perhaps only financial value creation in mind (KPMG 2012).

In connection to the legitimacy theory one can ask whether the companies disclose simply to legitimize themselves or because they feel it is their responsibility to inform stakeholders (Deegan 2007). The latter would require the management to accept responsibility and accountability, since they tend to be the ones who can choose what to disclose and what to leave out (Deegan 2007; Mallin & Ow-Yong 2012). This would mean that nothing material could be left out simply because the stakeholders have not recognized that they are requesting the information.

The IIRC recognizes the need to focus on communication rather than simply meeting legal requirements (IIRC 2011). An integrated report according to the IIRC is based on the business model and how this is affected by and affects the stakeholders as well as sustainably creates value (IIRC 2011). As Larsson (2009) describes in his book *Hållbar affärsutveckling* the goal is sustainability, which is defined as a world where resources are well preserved and not destroyed, whether it is economic, social, environmental or human resources. To be a sustainable company, the resources they are dependent on also need to be sustainable.

2.8 Disincentives for the companies

One disincentive connected to disclosures is the proprietary cost: for example the cost of disclosure and exposing company secrets to competitors (Frías-Aceituno et al. 2014; Mallin & Ow-Yong 2012). The cost of disclosure is argued to be seen as a minimal problem since this information has to be collected for internal use even if not externally disclosed (Frías-Aceituno et al. 2014). Preparing an integrated report also involves facing the challenge of *materiality*, deciding what to report (Massie 2010), and the company's decision of what to include in the

report demands thorough considerations (IIRC 2011). However, legal requirements may force companies to include non-material information. Zicari (2014) suggests that a distinction needs to be made between what is relevant information and what is only legal-compliance information, with the latter presented in an annex document.

Eccles and Saltzman (2011) argue that an integrated report can raise the question of reliability since the audit of voluntary disclosures is not currently achieving the same rigor as the audit of financial reports. Furthermore, they state that many companies lack high-quality internal control systems for non-financial information. These circumstances will cost time and money for the companies but according to Eccles and Saltzman (2011) integrated reporting is the best alternative for corporate reporting on the path towards a sustainable society.

2.9 GRI

Since the Global Reporting Initiative's (GRI) guidelines are used as inspiration when forming the questions in the scoring system a short explanation of who they are will be provided. GRI is a not-for-profit organization founded in 1997 with the mission to spread and improve sustainability reporting (GRI 2014a). They have produced guidelines for sustainability reporting since 2000 and the latest set, G4, was launched in 2013 (GRI 2014a). GRI's guidelines are widely used all over the world and have become the standard for companies that produce sustainability reports (GRI 2014b). One of GRI's current priorities is to develop integrated reporting and they are one of the co-founders of IIRC (GRI 2014c).

2.10 Size as an explanatory factor

The second research question concerns the possible relationship between compliance with the <IR> framework and the size of the company. Most of the previous research show that the amount of disclosures tends to increase with company size (e.g. Trotman & Bradey 1981; Belkaoui & Karpik 1989; Alnajjar 2000; Hahn & Kühnen 2013). One contributing factor is the greater need of larger firms for external financing, for which disclosures can be used as a signal to capital providers to help establish and maintain the relationship between the firm and the capital providers (Frías-Aceituno et al. 2014).

Disclosures can also be used by the company to send out signals to other stakeholders in order to legitimize themselves and since larger companies often affect a wider range of stakeholders it contributes to an increased amount of disclosures (Hahn & Kühnen 2013; Orojali Zadeh & Eskandari 2012). From the perspective of agency theory there might be a higher risk of agency conflicts due to, for instance, larger firms' greater need for external financing (Frías-Aceituno et al. 2014). Therefore, larger firms tend to disclose more to reduce information asymmetry.

This, together with the fact that corporate governance mechanisms exist to minimize the agency problems (Ho & Wong 2001), indicates that the larger the firm is, the more extensive governance mechanisms are required to control the agency problems. Specific disclosures of these corporate governance mechanisms and its structure are also known to minimize the agency conflicts (Mallin & Ow-Yong 2011).

Lang and Lundholm (1993) highlight that disclosures increase with firm size since the cost of disclosing *decreases* with firm size. Singhvi and Desai (1971) agree with the motivation that the cost is lower since the information is more likely to have already been produced for internal use. Larger firms also tend to have more extensive systems for corporate information, which facilitates the information gathering (Depoers 2000). However, the study of Lang and Lundholm (1993) is also questioning if this is the case regarding the total cost of disclosure, meaning voluntary information included. Watson, Shrives and Marston (2002) argue that this is the case, mentioning that the proprietary costs are lower in large firms. Frías-Aceituno et al. (2014) on the other hand mention that these costs probably are independent of the size of the firm. Despite this the authors stress that; the larger the firm the greater the possible benefits are of preparing the information, mainly referring to the decreased agency costs.

Prior research also concludes that larger firms face higher scrutiny by different stakeholders (Alnajjar 2000) and tend to be more exposed as they get more attention (Frías-Aceituno et al. 2014). Therefore they have more users that demand information.

3. Methodology

This chapter aims to explain how the study was performed. First, the motivations for this type of study are presented. This is followed by a presentation of the research design, including an explanation of the construction of the scoring system. Subsequently, the execution of the scoring system is presented and lastly what methods were used when analyzing the data.

3.1 Background to the study

The aim of this study is to assess how far Swedish listed companies have come in the process of implementing integrated reporting from the governance perspective. This can be evaluated using different approaches; examples include analysis of annual reports, interviews and surveys. The chosen method for this thesis is examinations of annual reports, as it is the annual reports that should be transformed into integrated reports. One advantage of analyzing annual reports is that they have long been considered the primary source of communication between a company and its stakeholders (Wiseman 1982; Eccles & Krzus 2010). In addition, it is a regularly produced report, which can easily be accessed (Wilmshurst & Frost 2000) and the credibility of the disclosures increases if presented in an annual report (Tilt 1994). Another advantage of analyzing annual reports compared to interviews is that a larger sample can be assessed. The study also aims to objectively measure the communication between companies and stakeholders through annual reports. Hence, the aim of the study is not to collect the subjective opinion of the companies, which would be the output of interviews. Furthermore, listed companies were chosen due to their greater need for transparency compared to private companies. Public companies are also found to disclose more and to be more transparent in order to establish and maintain a good relationship with investors (Frías-Aceituno et al. 2014).

The <IR> framework was used as the basis when performing the study, as this aims to be an internationally accepted framework (IIRC 2011), and therefore what Swedish companies would read when transforming their annual report into an integrated report. Other frameworks on integrated reporting exist. However, in the development of the <IR> framework, the people and the organizations behind many similar frameworks or guidelines have participated; examples include Professor Mervyn King behind King III and the Global Reporting Initiative behind the GRI guidelines. Over 135 multi-national companies and investors are also participating in the IIRC pilot program (IIRC 2014f), which displays support from both preparers and users. The <IR> framework by IIRC can thereby be seen as the most internationally accepted framework for integrated reporting. Integrated reporting and IIRC was further explained in the frame of reference.

The study is limited to the <IR> framework's content element governance. Only one content element was chosen in order to be able to focus on one area and fully explore it. Furthermore, this allows a larger sample, since the number of questions to assess is reduced, which enables more reliable conclusions to be drawn. The content element governance was chosen due to its essential and fundamental role for a company in its development towards integrated reporting. The role of the board of directors is crucial in the adoption of integrated reporting (Eccles & Krzus 2010). Furthermore, disclosures on governance and the governance structure are necessary to achieve the purpose of integrated reporting (Riche & Erasmus 2012). To reliably communicate how a company creates value it is necessary to include information regarding governance and its structure (IIRC 2013c). This is due to the fact that the governance has the responsibility to ensure that the company has the ability to sustain itself in the long-term (Eccles & Krzus 2010). To omit reporting on their structure and involvement will hamper the development towards integrated reporting (Riche & Erasmus 2012).

3.2 Research design

Integrated reporting is a fairly new concept, and even more so the <IR> framework. Therefore, as proposed by Blumberg, Cooper and Schindler (2011), a two-stage design of the study was chosen. During the first stage, the exploratory stage, the <IR> framework was interpreted to help develop definitions of the main concepts. An interview with Bo Lagerström⁶, who has led a similar study, was conducted as well. With the knowledge gained in this stage, a scoring system was created primarily based on the <IR> framework. More detailed information on the scoring system is found below in 3.2.1 and in appendix 1. The activities in this stage also created an understanding for integrated reporting, which is essential for conducting a reliable execution of the scoring system and analysis.

The second stage, the formal stage, is characterized by clearly stated hypotheses or investigative questions (Blumberg et al. 2011). As the aim of this thesis was to find to what extent annual reports meet the guidelines of the <IR> framework, a descriptive approach was suitable in contrast to a causal one (Blumberg et al. 2011). To fulfill the purpose, annual reports were analyzed. The disclosures in the annual reports were assessed using content analysis. This method has been used in several previous studies to assess disclosures in annual reports (Guthrie & Abeysekera 2006). Content analysis consists of manual or automated coding, which means categorizing the content of for example a document (Blumberg et al. 2011) in order to draw replicable and valid conclusions from texts (Krippendorf 2004).

⁶ Bo Lagerström, partner and specialist in corporate reporting at PwC, telephone interview February 11th 2014.

The appropriateness of the source must be thoroughly assessed (Blumberg et al. 2011). As it is the similarity between today's annual reports and an integrated report according to the IIRC that is being analyzed, the source of annual reports is given. The annual report is the only company information that has been studied, not the website, the sustainability report or other reports. This may be seen as a limitation as the information needed to comply with the <IR> framework may be disclosed elsewhere today. However, since the aim of integrated reporting is to comprise relevant information into one report, this study only assesses annual reports. The <IR> framework (IIRC 2013b) states that the integrated report, as a single document or distinguishable part of another report, should answer the question of how the governance structure supports the organization's ability to create value.

After finding the source, the coding procedure must be defined. Themes, i.e. what is searched for in the texts, can be found when going through the data or defined from the start (Blumberg et al. 2011). For this study a predetermined scoring system was constructed. The design of the scoring system is not intended to identify certain words or phrases, but to assess whether certain criteria are found in the text, as it allows the extent and specificity of the disclosures to be measured, meaning that the study reveals not just what is being reported on or how much but also if the disclosure contains enough details to inform the reader of how the ability to create value is enhanced. This has its similarities to what is referred to as an open perspective (Blumberg et al. 2011). The meaning behind the items of the scoring system needs to be fully understood by the researchers and defined in detail, as a general problem of an open content analysis is that what is discovered in the beginning has the risk to influence the continuation of the study (Blumberg et al. 2011). To avoid this, the assessments of a certain item were constantly compared to each other.

3.2.1 The scoring system

This section provides a description of the scoring system and states the motivations behind the structure. The full version of the scoring system is found in appendix 1. The items, or questions, of the scoring system are primarily based on the <IR> framework. The area of governance in the <IR> framework was broken down into operational questions with the help of prior studies on the subject (PwC 2013a; PwC 2013b), a report on what integrated reporting looks like by KPMG (2012) as well as the GRI-G4-guidelines. In order to get acquainted with the topic and type of study an interview was conducted with Bo Lagerström⁷, who led the PwC benchmark study.

⁷ Bo Lagerström, partner and specialist in corporate reporting at PwC, telephone interview February 11th 2014.

In order to find a suitable structure for the scoring system, previous studies with the aim of identifying corporate social responsibility disclosures using scoring systems were studied. The studies include Singhvi and Desai (1971), Buzby (1974), Wiseman (1982), Alnajjar (2000) and Wang, Song and Yao (2013). Buzby (1974) identifies three groups of questions for analyzing annual reports. One of these groups contains questions answering to what degree something is disclosed; step one a general comment and step two a specified text. All questions of this scoring system have this structure, assessing the annual reports by evaluating the degree of specificity. This type was chosen, as the aim of this thesis is to evaluate to what extent the <IR> framework is fulfilled in today's annual reports. Wang, Song and Yao (2013) have used a similar structure for analyzing disclosures on corporate social responsibility, giving a score of zero if not disclosed, one if disclosed qualitatively without explanation and lastly two if disclosed in detail. There is no linear relationship between the points in the index; meaning that 2p is not twice as important or good as 1p.

The scoring system constructed for this study has the following structure:

0p - Nothing mentioned	2p - Describes
1p - Mentions	3p - Linkage to the ability to create value

The content element governance in the <IR> framework (IIRC 2013b, paragraph 4.9) begins with the question: ***How does the organization's governance structure support its ability to create value in the short, medium and long term?*** As explained under the heading *The <IR> framework*, the question, which has to be answered in the integrated report, is followed by guidelines, which help companies answer the question in bold. The area of governance includes seven guidelines, from now on called areas, upon which this scoring system is based. An eighth area, *statement by the board of directors*, was added, since this is a criterion connected to governance but situated in the beginning of the <IR> framework (IIRC 2013b, paragraph 1.20, see appendix 3).

One of the seven areas under governance, area 5, was furthermore excluded. The <IR> framework states in the fifth area that it should be disclosed in an integrated report whether the governance practices exceed legal requirements. This area was excluded from the study due to the lack of explanatory information on the subject. It is unclear whether the companies should explicitly state what is done beyond legal requirements or not. Furthermore, a question arose concerning how to evaluate companies with different legal requirements. If it is desired that companies implement governance practices that exceed legal requirement to a large extent, companies in environments with low legal requirements can more easily go beyond them. This would not have been an issue in this study, since all companies work under the same legal

requirements, but it creates an uncertainty as to what the guideline is striving for. Therefore, as it is not clear what the question would contribute with, it was excluded.

All areas do not have the same amount of questions in the scoring system due to the fact that every area does not have an equal number of dimensions. Neither will there be a comparison made between the different areas, which makes it irrelevant to have the same number of questions.

Each question of the scoring system includes a justification for the question together with guidance of how to apply the specific question when reading annual reports (see appendix 1). In the justification section the background of and reasons for the question are explained. Most of the questions have their foundation in the <IR> framework. Several are also inspired by the GRI's criteria included in the GRI-G4-guidelines, as these guidelines are more specific than the guidelines in the <IR> framework. In addition, one of the objectives with the GRI-G4 is to guide companies in the process of linking sustainability reporting and integrated reporting (GRI 2013). Therefore, it is suitable as an inspiration for this scoring system. Inspiration was furthermore gathered from other reports such as King III and reports by PwC and KPMG. Examples of good integrated reporting according to IIRC, accessible in IIRC's emerging integrated reporting database, are also presented in this section when available.

The guidance section includes what to have in mind when applying the scoring system and specific examples of how to earn the points are given to clarify what is meant. Common to all areas is that to receive a higher score the prior criteria must be fulfilled; meaning that one cannot receive 3p unless both 1p and 2p have been earned. When scoring the annual reports, many assessments had to be made. This was also a reason for including the guidance section, as the assessments may reduce the ability to successfully replicate the study, thereby being a threat to the reliability and validity of the study. Despite this guidance one cannot ignore the fact that the study includes assessments and that the results may be affected by these.

A limitation with the scoring system is that it does not take materiality into account. The scoring system is based on the guidelines in the <IR> framework. These guidelines should help the company decide what to include when answering the question of how the governance structure support value creation. If disclosing information in line with one of the guidelines results in information that is not material, it should not be included. This is not considered when scoring the annual reports. All companies that for example do not mention anything about how innovation is supported receive 0p, despite the fact that the information for some companies may not have been material to include. Furthermore, it was not assessed whether the disclosures

are good or true, but simply if the companies disclose. For example, in question 6 it is not the aim to assess the quality or likelihood of success of the ways to support innovation, only what is disclosed.

This study compares the annual reports of 2013 with the guidelines in the <IR> framework published in December 2013. This means that the companies that wanted to use the <IR> framework had not had a long time to understand and apply the framework. What should be noted, however, is that the guidelines in the area of governance have generally been the same since the publication of the consultation draft in April 2013. The fact that the <IR> framework is new makes it interesting to perform similar studies in the future to map the development.

3.3 Execution of the scoring system

When performing the study the annual report was first once read through, in order to get acquainted with the business model and strategy, as this is important to know when for example assessing the potential link to the ability to create value, i.e. receive 3p. Comments were added to the annual report when reading something that could be linked to a question in the scoring system. Secondly, a scoring table (see appendix 2) was filled out stating what score is earned by the report for each question in the scoring system. This was done using the guidance provided in the scoring system (see appendix 1). Step one and two were performed by two coders separately in order to achieve reliability (Guthire & Abeysekera 2006). As a third step the two coders' scoring tables of a specific company were compared. If different scores were given, this question was thoroughly assessed again. Furthermore, to secure that the assessments were kept consistent, the first two evaluated annual reports were re-assessed at the end.

3.4 The sample

The sample consists of 21 annual reports from the financial year of 2013 and were chosen regardless of their attitude towards the <IR> framework, meaning the annual reports in the sample are not prepared in accordance with the <IR> framework. A list of the companies on the OMX Nordic Stockholm was exported to excel on the 24th of February 2014 and were thereafter randomly sorted⁸. The segments, large, mid and small cap, were kept separated in order to have a sample with an equal number of companies from the three segments.

After the random sorting of the companies the first companies were chosen. If a company was chosen it was examined further using two factors. The factors were that the annual report had to be published before the 21st of March 2014 and that it had to be a Swedish company. The

⁸ The companies were randomly sorted in excel through the following steps: given a random number - copy number column - paste special – values - sorted on these numbers starting with the smallest number.

sample consists of the top seven companies that fulfilled these two factors from each segment: large, mid and small cap. A list of the companies in the sample is provided in table 1.

Small cap	Mid cap	Large cap
Björn Borg	Arcam	Boliden
Connecta	Avanza	Latour
Dedicare	Cloetta	Saab
Enea	Gunnebo	Scania
Hemtex	IFS	SEB
Naxs	Mekonomen	SKF
Ortivus	Öresund	TeliaSonera

Table 1: The companies in the sample

When determining the sample size annual reports were added until reliable conclusions about size could be drawn. To find an appropriate sample size, the average score in each of the three segments⁹ were analyzed. To begin with, five annual reports from each segment were scored. Then a sixth annual report was added to each segment. It was pre-decided that if this changed the average score of the segment with more than one point another annual report was added in all segments, including those segments that fulfilled the criterion. The score of the seventh annual report changed the average score of small cap with 0.5p, mid cap 0.6p and large cap with 0.4p, see table 2. This meant the criterion of not changing the average score with more than one point was fulfilled.

	Small cap	Mid cap	Large cap
Average score <u>before</u> a seventh annual report was added to the sample	10.2p	12.5p	18.5p
Average score <u>after</u> a seventh annual report was added to the sample	9.7p	13.1p	18.9p
Change of average score	0.5p	0.6p	0.4p

Table 2: Determination of sample size

⁹ The total score of the companies in small, mid and large cap respectively divided by the number of companies in the sample in the segment.

3.5 Analysis of the collected data

The aim of the analysis was to draw conclusions from the findings. To enable an effective analysis of the findings in the annual reports the scores from the scoring tables were gathered in a document. In some cases the annual reports were clustered into three groups depending on their score, 0-9 p, 10-19 p and 20-30 p. This was done in order to facilitate the analysis. When used, it was found to increase the understanding and significantly clarify the inferences.

In previous studies, size has been found to be positively correlated with integrated reporting (Frías-Aceituno et al. 2014). Previously, Swedish studies on integrated reporting have, however, focused mostly on the largest companies, see for example PwC 2013a. Therefore, the results from this study were analyzed with size as an explanatory factor, in order to examine if large companies produce annual reports that are more in line with the <IR> framework in the area of governance. Firm size was measured by market capitalization since this is what determines if a company is listed on the small, mid or large cap. Companies with a market capitalization of less than EUR 150 million are listed on small cap. Mid cap are those companies with a market capitalization between EUR 150 million and EUR 1 billion. Those companies larger than EUR 1 billion are listed on the large cap (Nasdaq OMX 2013 p. 8).

Determining the measurement for size is relevant for an analysis (Orojali Zadeh & Eskandari 2012) and there are various ways of measuring firm size in addition to market capitalization; sales, total assets, turnover, and number of employees (Hahn & Kühnen 2013) to mention a few. Previous studies in the area of size as an explanatory factor of disclosures has shown that the choice of measurement can affect the result, meaning two different ways of measurement can give dissimilar results (Orojali Zadeh & Eskandari 2012). This indicates that the choice of measurement for size in this thesis might affect the result and should therefore be taken into account.

When analyzing the data, signs of a relationship were observed between a question in the scoring system and the total score. In order to further test this relationship the data was statistically analysed using SPSS¹⁰. The same method was used to statistically test the relationship between the extent of compliance with the <IR> framework's content element governance and the size of the company, as stated in research question two. Due to the rather small sample, the tests were executed using Fisher's exact test in SPSS. A significance level of 99 % was used. The p-value was calculated in order to find whether the relationship depended on chance or not. To test the type of relationship Spearman's correlation test was used. For both

¹⁰ SPSS is a software for statistical analysis.



tests the simulation Monte Carlo was used, since the tables are larger than 2x2. In these tests the clustered groups, 0-9p, 10-19p and 20-30p, were found very helpful as these reduced the number of rows. Instead of having one row for each possible score, the rows were decreased to three. The analysis of size was constructed as shown in table 3.

	Small cap	Mid cap	Large cap	Total
0-9 p				
10-19 p				
20-30 p				
Total				

Table 3: Example of table for analysis

4. Empirical results and analysis

In this chapter the empirical results from the study are presented together with an analysis of the findings. The chapter is structured by the two research questions. First, the findings regarding the extent to which Swedish listed companies comply with the <IR> framework's content element governance are presented and analyzed. This section contains three parts: overall findings and analysis, a presentation of the company with the highest and lowest score together with possible explanations for this, and an outline regarding the results divided by the ten questions in the scoring system. Subsequently, the second research question, concerning the possible relationship between the results of the study and the size of the company, is presented and analyzed.

4.1 Extent of compliance with the <IR> framework

The 21 annual reports in the sample were assessed and scored using the scoring system presented in appendix 1. The scoring system contains a total of ten questions. For each annual report and each question a score from 0 to 3 was given, meaning a company could receive a maximum of 30 p. Table 4 summarizes the total scores of the 21 companies in the sample. In chart 1 the scores per company are presented. This chart also shows the distribution of the scores within the intervals in table 4.

Score	Number of companies	Percentage of companies
0-9 p	5	24 %
10-19 p	12	57%
20-30 p	4	19 %
Total	21	100 %
Average score	13,9p	
Mode score	12p and 14p	
Maximum score	30p	

Table 4: Summary of the scores

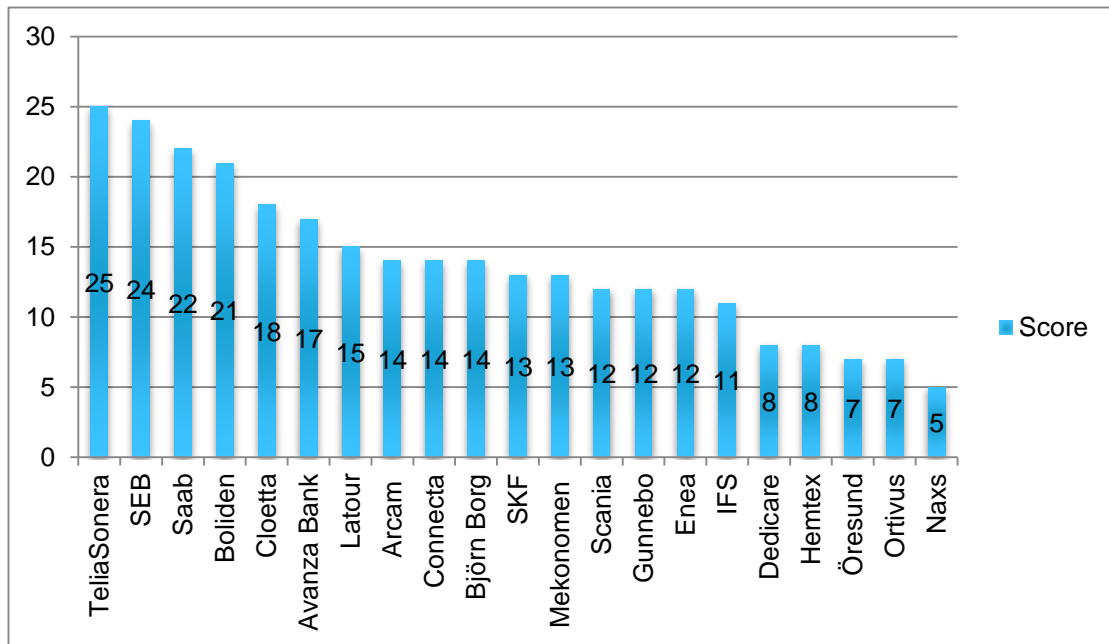


Chart 1: Scores per company

Table 4 highlights that companies to a large extent received 10-19p. More specifically, the most frequently occurring score, the mode score, was 12p and 14p. In the range between 12p and 14p, eight companies were found representing 38% of the sample. The general characteristic of these annual reports was that they mentioned the majority of the aspects in the <IR> framework's area governance, i.e. received 1p. Furthermore, they generally received 3p in one or two questions and the same amount of 0p. It can be concluded that the majority of the annual reports include something related to all guidelines found in the <IR> framework's area governance. However, the companies have several areas that need to be improved and described better before fulfilling the guidelines and answering the question of how the governance structure supports value creation.

Given the importance of governance disclosures and the advantages of producing an integrated report, as presented in the frame of reference, companies should consider improving their disclosures on governance and its structure. The cost of disclosing would not rise, at least not substantially, as they already have to produce part of the information for internal use (Frías-Aceituno et al. 2014) and are required by the Swedish corporate governance code to issue some sort of corporate governance report.

Furthermore, since a broad set of stakeholders have been taking part in the development of the <IR> framework it can be seen as representing what information stakeholders are demanding. Thus, if the annual reports of the companies are not in line with the <IR> framework, a gap

between what stakeholders demand and what the companies provide may still exist. In addition, previous studies reveal for example that by improving the governance disclosures the company enhances the credibility of the entire report and creates confidence in the expressed future actions. It should also be mentioned that integrated reporting has been argued to enhance the efficiency of the entire company (Lennartsson 2014), which should further motivate companies to implement integrated reporting.

Worth mentioning is also that the impression was that some companies had very good annual reports with well-described, transparent and non-generic disclosures with the exception of the corporate governance report. This indicates that Swedish companies might have come further along in the <IR> adoption process as a whole than this study, focused on governance, indicates. The two most apparent examples of the phenomenon were SKF and Scania. The beginning of the annual reports, where for example the business model and culture are presented, was well described with links to value creation. However, when reaching the corporate governance report, where most of the information to answer the questions in this scoring system can be found, the text became generic and short. Not much more than required by the Swedish corporate governance code was disclosed. This finding supports the conclusion in PwC's benchmark study (PwC 2013a) that governance is the least well-reported area.

4.1.1 Highest score – TeliaSonera

One of the contributions of this thesis is to find examples of good ways of reporting on governance, since no best practice on integrated reporting has yet been established but is a way to enhance the implementation (Lennartsson 2013). The company receiving the highest score was TeliaSonera and therefore their score will be commented per question to further increase the understandability of how to report on governance according to the scoring system of this thesis. TeliaSonera, with a total of 25p, received 3p in six out of ten questions. In those questions where TeliaSonera failed to reach the highest point, an example of another company will be provided when available.

4.1.1.1 Good examples per question

In question 1a, concerning *the composition of the board*, TeliaSonera received 2p. None of the companies in the sample earned 3p in this question. Similar to all companies that received 2p, TeliaSonera earned their points by disclosing a table in the notes where the gender distribution of the board is stated. However, there exists significant room for improvement concerning this question. An easy improvement would be to include the gender distribution in the corporate governance report instead of in the notes, where it is easier to overlook. Furthermore, additional factors of diversity could be highlighted. 3p would have been earned if, for instance, an

explanation of how the different members of the board contribute with needed knowledge had been included.

In question 1b, concerning *the nomination committee*, TeliaSonera was one of two companies in the sample to receive 3p. The strategy of their nomination committee is transparent and well described with linkage to the overall strategy of TeliaSonera. This is apparent in the description of how the nomination committee receives relevant information about the strategic direction of the company and how they, based on that information, assess what competences are necessary on the board.

In question 2a, concerning *the strategic decision-making process*, TeliaSonera was one of four companies to receive 3p. In the corporate governance report, TeliaSonera includes an explanation of their governance framework and how they decide on what to achieve. Detailed descriptions of the responsibilities and the tasks of the board and the committees are included as well as an extensive explanation of the board's annual work cycle. Overall this highly contributes to insight into the strategic decision-making process.

Question 2b, concerning *specific processes used to establish and monitor the culture of the company*, is the question where the most companies received 3p, namely 12 companies out of the 21 companies in the sample. Among those was TeliaSonera. In their corporate governance report they describe their *code of ethics and conduct* and how the employees take part of it through an e-learning tool. The linkage to value creation is evident since the *code of ethics and conduct* is included in TeliaSonera's governance framework, which describes the governance structure's role in the value creation process.

In question 3a, concerning *the board's strategic activities during the year*, TeliaSonera was one of seven companies to receive 3p. The chairman of the board introduces the corporate governance report and talks about the priority areas of the board during the year with specific actions taken and why. Further down in the corporate governance report they continue to mention several, non-generic strategic actions taken by the board. Some of these specific actions are discussed in detail and connected to the strategy in other parts of the annual report.

In question 3b, concerning *the board's risk-management related activities during the year*, four companies received 3p and TeliaSonera was one of them. In their corporate governance report they give several examples of actions taken by the board to influence risk management and why they are taken. They mention the implementation of risk catalogues as a strategic action as well

as actions taken to review the overall sustainability risks. The latter includes the implementation of a new ethics and compliance function.

In question 4, concerning *the reflection of culture when using and affecting the capitals*, TeliaSonera was one of 11 companies to receive 3p. In the structure of TeliaSonera's governance framework, which is thoroughly explained in their corporate governance report, values and other boundaries for how to act are included. The surrounding text clearly elaborates on the values and ethics, and actual examples of how for instance the values have influenced the actions are included.

In the area of *promoting and enabling innovation*, question 6, TeliaSonera only received 1p. An example from Saab's annual report of 2013 will therefore be provided since they were one of two companies receiving 3p. In the beginning of the annual report, the chairman of the board talks about the importance of innovation and what is done to enhance innovation. Even if the chairman does not explicitly mention what the board has done, the fact that he mentions what the company is doing to support innovation signals involvement and support from the board. Saab also links innovation to value creation by including innovation in the strategy.

TeliaSonera did not manage to reach 3p in question 7, concerning *remuneration and incentives*, either. Instead Mekonomen is included as an example since they received 3p together with two other companies. Mekonomen states the importance of ensuring the linkage between remuneration and goals, both in the short and long term, as well as values of the company, see figure 13 in appendix 1. This is a clear example of a linkage to value creation.

In question 8, concerning *statement by the board of directors*, none of the companies received 3p. This was not surprising since none of the companies have stated that they produce an integrated report in accordance with the <IR> framework. However, TeliaSonera was one of five companies to receive 2p, meaning they have included a statement by the board introducing the corporate governance report.

4.1.1.2 Possible explanations behind the high score

The review in the section above highlights the importance of a transparent and non-generic annual report in order to answer the questions of this thesis' scoring system. Especially the significance of a transparent and non-generic corporate governance report is prominent since this greatly contributes to a high score. As mentioned above, TeliaSonera was the company receiving the highest score in this study. However, in connection to TeliaSonera it is worth mentioning that they have had major governance changes during the year due to the corruption

scandal of 2012. TeliaSonera needs to disclose these changes, otherwise the stakeholders cannot assess the quality of the company properly. Hence, in order to differentiate oneself from other companies, i.e. reduce the information asymmetry, disclosures of these changes are necessary. Thus, the high quality of the governance disclosures is clearly important for TeliaSonera, which could explain their high score.

Furthermore, it is interesting to relate the high score of TeliaSonera to the legitimacy theory. Their high score in this study indicates that they try to regain the legitimacy among their stakeholders, which was lost in the corruption scandal, since disclosures are a way of achieving this. Reasons for this search for legitimacy include the desire to increase capital inflow, customer appreciation, and labor participation (Mahadeo et al. 2011). The disclosures also need to be credible (Akerlof 1970; Healy & Palepu 2001) to help repair the conflict of trust. The high score of TeliaSonera might indicate that they have noted that disclosures on governance structure affect the reader's view of the credibility of the entire set of disclosures and the value creation process (IIRC 2013c).

The result of TeliaSonera can also be related to the stakeholder theory. Corruption scandals are not accepted by society and TeliaSonera's high score in this study might indicate that they consider a broad range of stakeholders instead of only the shareholders. This is evident in the annual report where it is stated that the CEO has implemented a program to regain the confidence of their stakeholders (TeliaSonera 2013). This statement also contributes to creating confidence among the stakeholders that the company is working in line with the interest of the stakeholders, i.e. the statement reduces the risk of agency conflicts according to the stakeholder-agency theory. Worth mentioning is also that the scandal might not have been discovered if TeliaSonera had been a smaller company, since the attention and scrutiny from stakeholders increase with size.

4.1.2 Lowest score - Naxs

The company receiving the lowest score was Naxs. In over half of the questions Op was received, meaning Naxs fails to disclose information in several areas. Naxs is an investment bank and when analyzing the data investment banks were found to receive low scores. A small analysis regarding sector was therefore conducted. As the sample of this study is rather small all sectors are not represented and in several sectors there are only one or two companies. Thus, it was not possible to perform an appropriate analysis with sector as a possible explanatory factor for integrated reporting. However, an indication of investment banks receiving low scores was found.

In the sample there are three investment banks, one in each segment. The investment bank in small cap, Naxs, received 5p, which is the lowest overall score. The investment bank in mid cap received 7p, which is the second lowest overall score. The third investment bank is listed on large cap and received 15p, which is an average overall score. Thus, this study indicates that investment banks to a lower extent produce reports similar to integrated reports. This thesis does not aim to find explanations to why this is the case. However, worth mentioning is that these investment banks have few employees, which could have a connection with why the annual reports contain nothing or very little about the culture of the organization. On the other hand, Naxs has contractual personnel and these might need values in order to work in line with the strategy of the company. How these values are implemented might in that case be even more important if the personnel turnover is high. This indicates that Naxs at least has a couple of areas that need improvements.

4.1.3 Materiality as a limitation

The fact that TeliaSonera provides extensive governance disclosures and Naxs does not, provides a concern towards the fact that materiality was not taken into account in the study and might be a limitation. What is material for one company might not be material for another. TeliaSonera clearly has a lot of information that is material and therefore needs to be disclosed. For other companies, such as Naxs, all questions in the scoring system might not need to be answered with a link to value creation in order to answer the main question, *how those charged with governance support value creation*. If this is the case they might still be in line with the <IR> framework even if they do not receive a high score in this scoring system. However, the conclusion of this study is still that several improvements are necessary for Swedish listed companies, with Naxs as a prominent example, in order to enhance the understandability of governance and its structure. The issue of materiality is further explored below, in relation to the discussion of size as an explanatory factor of governance disclosures.

4.1.4 Results divided by question

Table 5 summarizes the scores per question in the scoring system. This table also indicates that there is a wide range in the quality of the annual reports' governance disclosures. On average 25 % of the annual reports received 0p. Just a few percent fewer, 21 % of the companies, received 3p, which is also the percentage for 2p. The most commonly received score, 33 % of the annual reports on average, was 1p. This generalization, however, is not the best way to look at the results as these vary greatly from question to question. Therefore, the results per question will be described below. An analysis of *why* certain questions were better reported than others is not within the scope of this study and will therefore not be provided.

Question	0p	1p	2p	3p	Average
1a	0 (0 %)	3 (14 %)	18 (86 %)	0 (0 %)	1,9
1b	19 (90 %)	0 (0 %)	0 (0 %)	2 (10 %)	0,3
2a	0 (0 %)	12 (57 %)	5 (24 %)	4 (19 %)	1,6
2b	4 (19 %)	4 (19 %)	1 (5 %)	12 (57 %)	2,0
3a	0 (0 %)	14 (67 %)	0 (0 %)	7 (33 %)	1,7
3b	3 (14 %)	12 (57 %)	2 (10 %)	4 (19%)	1,3
4	4 (19 %)	5 (24 %)	1 (5 %)	11 (52 %)	1,9
6	8 (38 %)	11 (52%)	0 (0 %)	2 (10 %)	0,8
7	0 (0 %)	6 (29 %)	12 (57 %)	3 (14 %)	1,9
8	14 (67 %)	2 (10 %)	5 (24 %)	0 (0 %)	0,6
Average	5,2 (25 %)	6,9 (33 %)	4,4 (21 %)	4,5 (21 %)	

Table 5: Number (%) of companies receiving 0p, 1p, 2p or 3p divided by question

The main finding from table 5 concerns question 1b, *the nomination process*. This was the area least well reported. The vast majority mentioned nothing on why members of the board were chosen. The aim of this study is not to provide possible explanations for why certain areas are well or not well reported on. However, it should be highlighted that this question is not explicitly mentioned in the <IR> framework, but was included in this scoring system since the issue of poor nomination process reporting was discussed in PwC's study *Bästa bolagsstyrningsrapportering 2012* (PwC 2013b). This thesis therefore supports PwC's finding that disclosures on the strategy of the nomination committee need to be improved.

In contrast, question 2b, *the process for establishing and monitoring the culture of the organization*, and question 4, *the reflection of culture when using and affecting the capitals*, were well described in the annual reports. Half of the companies even received 3p, meaning they explained how the desired or current culture would create value or help the organization reach their goals.

Question 1a, *composition of the board*, and question 7, *remuneration and incentives*, were also well disclosed. In comparison to question 2b and 4, however, these questions' relatively high average scores were obtained by a vast majority of companies receiving 2p in these areas. This implies that the companies provide descriptions of the areas but fail when it comes to linking the provided information to value creation.

The poor reported questions 6 and 8 are also worth mentioning. Concerning question 6, *promotion and enabling of innovation*, only two companies, representing 10 % of the total, received a score higher than 1p, meaning 90 % of the companies did not mention how the board helps support, promote or enable innovation. A frequent way was to explain how innovation was supported in the organization, sometimes very thoroughly, but no description of what the board does in the process was provided. This issue was also evident concerning question 3b, *the board's risk management related activities during the year*.

Question 8, *statement by the board*, was the second least well reported area, after the nomination process. Two thirds of the companies had not included a statement by the board in the annual report and no company received 3p. From this it can be concluded that no company produces an integrated report following the <IR> framework, as the statement is stated as a requirement.

4.1.4.1 Relationship between the result and the existence of a statement by the board.

In relation to question 8, an interesting indication of a relationship was found when analyzing the data. Table 6 shows the result from the study divided by those annual reports with a statement by the board and those without. All annual reports with a score of 20p or higher had a statement. In addition, all companies with a score of 9p or lower did not have a statement by the board. This indicates that companies that choose to include a statement by the board in the annual report are further along in the <IR> implementation process, i.e. better answer the question of how the governance structure supports value creation. One reason might be that a statement by the board brings transparency and credibility to the annual report. In addition, the statements are rarely generically written, thereby giving insights into the work and priorities of the board during the year.

	Without statement	With statement	Total
0-9 p	5	0	5
10-19 p	9	3	12
20-30 p	0	4	4
Total	14	7	21

Table 6: Results divided by existence of a statement by the board

A statistical analysis was performed to see if the relationship depended on chance or not. This was done using Fisher’s exact test with a significance level of 99%. The p-value was found to be 0.004, meaning the risk that the relationship was established by chance is 0.4 %.

4.2 Size as an explanatory factor

Table 7 shows the observed results from the study divided by size. This study found a positive relationship between the extent of compliance with the <IR> framework’s content element governance and the size of the company, meaning the larger the company is, the more the annual report of the company complies with the <IR> framework’s content element governance. To substantiate the observed relationship a statistical analysis was conducted. Using Fisher’s exact test the p-value was calculated to 0.006, meaning the risk that this relationship is established by chance is 0.6%. Further the type of relationship was tested using Spearman’s correlation test. This test showed a significant positive relationship; the value of the Spearman correlation was 0.713 and the value of the significance was 0.001. This relationship has, as described in the frame of reference, been established before mainly concerning voluntary and corporate social responsibility disclosures (Trotman & Bradey 1981; Belkaoui & Karpik 1989; Alnajjar 2000; Hahn & Kühnen 2013), but also lately integrated reporting (Frías-Aceituno et al. 2014).

	Small cap	Mid cap	Large cap	Total
0-9 p	4	1	0	5
10-19 p	3	6	3	12
20-30 p	0	0	4	4
Total	7	7	7	21

Table 7: Results divided by size of the company

One reason for this positive relationship may be larger firms greater need for external financing (Frías-Aceituno et al. 2014). The capital market transactions hypothesis states that disclosures decrease companies’ cost of external financing. Hence, a company with greater need for external financing has more to gain from disclosing. Furthermore, the agency theory can explain the findings. The sample of this thesis consists of listed companies, where there is a higher risk for agency conflicts compared to private companies, as agency conflicts occur when the role of management and the role of financier are separated. This theory has also been expanded to include all stakeholders, not just the shareholders. Larger companies tend to have larger impact on the society, meaning they have more stakeholders. Thus, larger companies are in greater risk of agency conflicts and have therefore greater need for disclosing regarding

governance, since those charged with governance are responsible for making sure that the company is managed in line with the stakeholders' interests.

The discussion above concludes that the larger the firm, the higher the risk of agency conflicts. It is also known that corporate governance mechanisms exist in order to minimize the agency conflicts. Therefore, it can be presumed that the larger the firm, the more extensive the governance mechanisms are required to be to control the agency conflicts. Hence, a natural consequence is that more information is available on the structure of these mechanisms, which in turn can affect the amount of disclosures presented by the company. Previous studies are divided in the opinion if the cost of the disclosures decreases with size. However, if this is true it is an additional explanation to why larger firms are more in line with the <IR> framework's content element governance.

4.2.1 Discussion on two issues with the study

This study concludes that the relationship between voluntary disclosures and size, found in several previous studies, is also true regarding the specific area of governance within integrated reporting. However, two issues should be discussed in relation to this, which could be seen as limitations. Earlier the limitation of materiality was raised and in the previous paragraph larger companies' need of more extensive governance mechanisms was explained. These two issues could mean that smaller companies are not supposed to earn as high scores as large companies in this scoring system as they do not need these large-scale governance structures as for example TeliaSonera do. This is probably to some extent true. Materiality was not possible to take into account, as this is information that only the companies possess. The result from this may be that some companies have received lower scores than they deserve with regard to how well they actually meet the guidelines in the framework. This issue could, however, occur for companies of all sizes.

The second issue, concerning the existence of more extensive governance mechanisms in larger companies, on the other hand, should not be seen as a limitation to the study. The goal of the <IR> framework is to help display the value creation process and regardless the size of the company value needs to be created. Therefore, the scoring system of this thesis was not designed in a way that more disclosures from the companies meant higher score, although details were of course sometimes necessary. The focus was on whether the support of the value creation process was disclosed. When a smaller company explained why they for example did not have a remuneration committee it did not hamper their ability to reach a higher score and perhaps the board of a smaller company would not need as many pages as a larger one to explain what they have done during the year and why, but it should just as well be described. Therefore

this study indicates that the reason for larger companies' higher scores, meaning better compliance with the <IR> framework's content element governance, can be explained by the fact that larger companies have more to gain and not because they have more extensive governance mechanisms.

5. Conclusions

This chapter presents the main findings and conclusions from the performed study. When doing so the purpose of the thesis is fulfilled. At the end of the chapter suggestions for further research on the area are presented.

5.1 Main findings and conclusions

From this study it can be concluded that governance disclosures should be improved in order to fulfill the guidelines in the <IR> framework content element governance. The most frequently occurring scores were 12p and 14p out of the maximum of 30p, meaning the majority of the studied companies mention the different aspects presented in the <IR> framework's content element governance. However, on several areas the descriptions are too short and generic resulting in an insufficient amount of information to answer *how those charged with governance support the organization's ability to create value*. Without this being answered the annual report is not in line with the <IR> framework.

Even though the results of the study show that the area of governance is poorly reported, no conclusion can be drawn about the extent to which Swedish listed companies comply with the <IR> framework as a whole. However, the impression of some of the annual reports in this study was that they presented well-described, transparent and non-generic disclosures with the exception of the area of governance. The two most apparent examples of this phenomenon were SKF and Scania. This indicates that Swedish companies might have come further along in the <IR> adoption process as a whole than this study, focused on governance, indicates.

In contrast to the main finding, that governance disclosures needs to be improved, TeliaSonera's annual report of 2013 was found to comply with the <IR> framework to a large extent. In order to show companies favorable ways of disclosing on governance, examples of how TeliaSonera received their high score was provided. This is needed due to the fact that best practice has not yet been developed regarding integrated reporting. The high score of TeliaSonera was also found to possibly be explained by, for example, the legitimacy theory, as TeliaSonera is recovering from a major corruption scandal and need to regain the trust of the stakeholders.

With regard to the more specific findings on the extent of compliance with the <IR> framework, great variations were found between the questions in the scoring system. In question 2b, *the process for establishing and monitoring the culture of the organization*, 57% received 3p. In contrast, 90% of the companies received 0p in question 1b, *the nomination process*. One reason

for including question 1b in the scoring system was the fact that a previous study (PwC 2013b) found the disclosures on the strategy of the nomination committee in great need of improvement. Thus, this study supports this need of improvement.

A general finding when conducting the study, was the fact that a lot of information was generic and in regard to many aspects the responsibility taken or work done by those charged with governance was not disclosed. Examples of this include question 3b, concerning *the board's risk management related activities during the year*, and question 6, *promotion and enabling of innovation*. Companies often failed to receive higher scores due to their lack of information on what the board of directors does regarding these issues. Furthermore, it was found that these problems often were reduced when a statement by the board was included in the report. These statements were often very informative, explaining the role and responsibility of those charged with governance as well as giving specific examples of the work done and the focus of the board during the year. A statistical analysis was conducted to ensure the observed relationship between the existence of a statement by the board and the extent of compliance with the <IR> framework regarding governance. The analysis showed a significant relationship.

Regarding the second research question a significant positive relationship between the extent of compliance with the <IR> framework's content element governance and the size of the company was found. The relationship was established with a p-value of 0.006, meaning the risk that this relationship is established by chance is very low, less than 1%. The result is consistent with previous studies in the area of company size as an explanatory factor of voluntary disclosures as well as corporate governance disclosures. Possible explanations for this relationship include larger company's need for external financing and higher risk for agency conflicts.

To summarize, this study highlights the importance of corporate governance disclosures as a relevant factor for a company to consider in a world where stakeholders demand more information of the value creation process of the company. The result of the study indicates that listed companies in Sweden have large room for improvements regarding governance disclosures. These two factors leads to the overall conclusion of this thesis, that Swedish listed companies should focus more on governance reporting.

5.2 Implications for further research

When conducting this study many interesting questions outside the scope of this thesis were found. Since the <IR> framework is fairly new, it is an exciting area to study and also in great need of further research. Four suggestions for further research are stated below.

1. The <IR> framework was published in December 2013, meaning the companies are just starting to be able to produce reports in line with this framework. A longitudinal study would therefore be interesting to conduct in a couple of years to map the changes of annual reports, if there are any.

2. In addition, it would be interesting to perform similar studies as this one but on other content elements of the <IR> framework, since it was noticed when conducting this study that the corporate governance report in some cases was of lower quality than the rest of the annual report. This indicates that companies might be better in line with the <IR> framework regarding other content elements than governance. If this were the case an explanation for why would be interesting to find.

3. Furthermore, since an explanation for why certain questions in the scoring system were well reported and others poorly was not in the scope of this study, a study investigating this would be of interest.

4. Lastly, this study found an indication that companies in the investment bank sector poorly report in accordance with the <IR> framework's content element governance. However, the sample of the study was too small to ensure whether sector affects the amount of disclosures on governance. Therefore, a similar study but with a sample large enough for the variable sector to be analyzed as an explanatory factor for corporate governance disclosures, would be of interest.

6. References

This chapter contains a complete list of the references used in the thesis. All annual reports used in the study or referred to in text are stated at the end of the chapter.

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Appendices

Appendix 1 - The scoring system

The scoring system has the following structure:

Question

0p - Nothing mentioned	2p - Describes
1p - Mentions	3p - Linkage to the ability to create value

Justification

Guidance

Area 1: Board structure

1a) Composition of the board

0p - Nothing mentioned

1p - Mentions the characteristics of the board.

2p - Describes with a text/info-graphics the diversity and/or gender equality of the current board.

3p - Linkage to the ability to create value. There is a discussion on why the board has the chosen composition and how it is linked to the business model.

Justification:

It appears from the <IR> framework (2013b) that the structure, including skills and diversity, of those charged with governance should be provided in the report. The report should also explain how it is linked to the organization's ability to create value. The GRI-G4 (2013) provides guidelines, including that the governance structure should be reported on and characteristics such as gender and competences relating to economic, environmental, and social impacts should be disclosed. KPMG (2012) reports on what an integrated report should look like. In the area of governance KPMG states that the report should explain the logic behind the composition of the board and how it is linked to the organization's business model. This supports the criterion for 3p. This question is furthermore important since companies that recognize diversity as a desired component of the board composition, are found to provide more voluntary holistic information and have closer stakeholder engagement (Frías-Aceituno et al. 2013).

Guidance:

To earn 1p a description of the board members must be included in the annual report. Relevant information is for example education, experience and other board membership. This can often be found in the corporate governance report. To receive 2p the diversity of the current board should be highlighted. The IIRC points out the Crown Estate as a good example since they use info-graphics to show diversity (IIRC 2014j). What is important is that the information should reflect the diversity of the *current* board; hence a generic text is not enough. This type of information might be found as a table in the notes. For 3p a deeper discussion must be provided stating the link between the composition of the board and the organization's business model. An example of this would be to explain how the different members of the board contribute with needed knowledge.

1b) Nomination process

0p - Nothing mentioned about the characteristics behind the nomination process of the board.

1p - Mentions that some sort of diversity is one of the goals when choosing new board members.

2p - Describes what kind of diversity they are striving for (expertise, competence, gender) and/or gives examples (50% women)

3p - Linkage to the ability to create value. The strategy of the nomination committee and/or the suggested board members is in line with the strategy and goals of the organization.

Justification:

According to Kollegiet (2010) Swedish listed companies should have a nomination committee whose function is to propose board members. The nomination committee is appointed at the annual meeting of shareholders or in another way, which is decided at the general meeting. This question is not explicitly mentioned in the <IR> framework. However, it is included here based on the discussion in PwC *bästa bolagsstyrningsrapportering 2012* (2013b) and GRI-G4 (2013). In PwC's report (PwC 2013b) there is a discussion on how weak today's reporting is on why a certain person is nominated for the board. The authors want the nomination committee to report on what profiles in the board they are looking for. Furthermore, the authors wish the committee would connect their nomination to the organization's strategy and goal. This approach is supported by the GRI-G4 (2013), which states that the organizations should report on how and based on what criteria the board members are nominated and selected. The overall conclusion is that the work of the nomination committee is of great importance for the value creation process of a company.

Guidance:

The text below is taken from TeliaSonera's annual report 2013 as an example of how to reach 3p.

The Nomination Committee receives information from the Chair of the Board, other Board members and the CEO on TeliaSonera's position, strategic direction and other relevant circumstances. Based on this information, the Committee assesses the competences needed in the Board as a whole. The Committee has concluded that competences currently needed are experience from:

- The telecommunications industry and industries closely related to it
- Internet-based operations
- Relevant markets
- Market and consumer oriented operations
- Operational sustainability work
- Major listed companies

On the basis of these competence needs, the Nomination Committee evaluates the competences of the present Board members. Taking into account the competences needed in the future, the gender distribution on the Board, the competences of present Board members and the present Board members' availability for re-election, the Committee nominates Board members to the Annual General Meeting.

*Figure 2: Scoring example of question 1b
(Source: TeliaSonera's annual report 2013 p. 35)*

The report mentions and describes the different types of diversity relevant for the nomination committee, for instance gender distribution and competences, which gives them 1p and 2p. The text also provides insight in the working process of the committee and their strategy. They earn 3p due to the specific requested experiences that are listed and can be related to the strategic direction of the company.

Excluded dimensions of area 1

The <IR> framework also states that the report should inform about whether regulatory requirements influence the design of the governance structure. In this study this was chosen not to be included as a separate question, in order to comment on this on a more general basis. There are no requirements for the boards of Swedish listed companies concerning skills, diversity or gender. It could be mentioned that Sweden's neighbor Norway, since 2008, has legislated that at least 40 % of the corporate board should be women (Thorburn 2013; Folke & Rickne 2012).

The <IR> framework does not mention independence of board members or nomination committee. However, other reports (PwC 2013b, GRI-G4 2013, Kollegiet 2010) mention this

as a criterion. Several studies have investigated the importance of independence of directors with various results (Frías-Aceituno et al. 2013, Byard et al. 2006; Cheng & Courtenay 2006; Eng & Mak 2003; García-Sánchez et al. 2011; Prado-Lorenzo & García-Sánchez 2010). As the IIRC does not specifically mention independence as a characteristic to report on, this criterion was excluded in this study.

Area 2: Processes

2a) The strategic decision-making process

0p - Nothing mentioned

1p - Mentions something on how strategic decisions are taken, the process and what committees there are.

2p - Describes more thoroughly where and/or how strategic decisions are taken and how authority is delegated

3p - Linkage to the ability to create value by explaining the link between the strategic decision making process and strategy, future and/or goals.

Justification:

The <IR> framework states that the integrated report should give insight about the strategic decision making process. PwC (2013b) also highlights that it should be clear what the decision- and monitoring process looks like and where in the organization the strategic decisions are taken. KPMG (2012) states that there should be a link in the report between the decision making process and the business priorities, i.e. strategy and opportunities, as stated earlier in the annual report. GRI-G4 (2013) includes that organizations should disclose information on committees and how authority is delegated. In the Emerging integrated reporting database (IIRC 2014j) the IIRC uses the Crown Estate and Marks & Spencer as good examples. The IIRC states that in the integrated report of these companies a description of the different committees are provided. By informing on what responsibilities the committees have, the reader understands what decisions are delegated to the different committees. Another good example according to IIRC (2014j) is Schiphol, who distinctly state what targets the Board is working towards. These targets are derived from the company strategy, which, according to IIRC, shows that the top of the organization is committed to the strategy.

Guidance:

The assessing of the compliance with this area demands a more subjective approach. To facilitate the assessment and decrease the subjectivity some relevant areas have been in focus. What has been taken into consideration when assessing the reports is how well it is understood what the different bodies of the company actually do and are responsible for. The company

bodies in focus have been the board of directors and the committees since these are of major importance to the strategic decision making process. The delegation process mainly focuses on the CEO and possible business units. To receive 1p a brief description of the different bodies is enough including mentioning what committees there are which, for instance, Scania has done in their annual report of 2013. 2p demands more details and it should be clear what decisions are taken where. An extensive description of the responsibilities of the board and the committees together with an annual agenda for the work of the board contributes to fulfill the 2p criterion. The 2013 annual report of SEB provides a good example as the report has a detailed presentation of the tasks and responsibility of the board and the committees. It also describes how authority is delegated by including a description of the CEO and her committees. SEB have also received 3p due to the connection between the committees' work and the strategy of the company.

2b) Specific processes used to establish and monitor the culture of the organization, including its attitude to risk and mechanisms for addressing integrity and ethical issues

0p - Nothing mentioned

1p - Mentions something on how the organization will establish and monitor the desired culture.

2p - Describes, more deeply, the process to achieve the desired culture. How does the company ensure that the culture penetrate the company?

3p - Linkage to the ability to create value. An explanation on why and how the desired culture will create value and help the organization reach their goals is provided.

Justification:

The <IR> framework states that the report should explain the specific processes used to establish and monitor the culture of the organization. Culture is not easily defined. In this thesis corporate culture is defined as accepted ways to behave, norms and values shared in the company (Eriksson-Zetterquist et al. 2005; Tsui et al. 2006). There are different views on whether corporate culture can be influenced at all, but Tsui, Zhang, Wang, Xin & Wu (2006) conclude it is so. However, as culture is the shared assumptions of an organization, culture is not changed until visible among the people (Trice & Beyer 1993). The culture is, for example, affected by the governance through the selection of who is promoted and the company dress code (Eriksson-Zetterquist et al. 2005). Furthermore, culture can be developed through interactions between the people in the company and actions by the leaders (Tsui et al. 2006).

The GRI-G4 (2013) includes a question on the role of governance in establishing values. Another guideline in the GRI-G4 (2013) is to report on how concerns among the people in the company can be communicated which is why whistle-blowing is an example of how to reach 1p if it is only mentioned and 2p if more details are provided.

In addition, King III (IoDSA 2009) states several responsibilities of the board in managing the company ethics. These include building and sustaining an ethical corporate culture, determining and communicating ethical standards, implementing a code of conduct, and assuring compliance with this code. In this thesis explanations of these in the annual report are seen as examples of how culture is established or monitored.

Guidance:

This question is, similar to the prior one, a question that demands subjectivity to some extent. Since culture has a wide definition it might be hard to identify and interpret the information in the annual reports regarding this area. In this study the approach is to explore whether companies disclose *how* they work with establishing and monitoring the culture. To receive 1p it is enough to mention some sort of process, for example a whistle blowing system, code of conduct or an employee/leadership program, which includes culture. 2p demands a deeper explanation of how the process actually is implemented in the company and among the employees. IFS has in this study received 1p since they mention their code of conduct but fail to communicate in a clear manner how it permeates the organization and how they ensure that the employees take part of the code. SKF provides a good example of 2p and 3p in their annual report of 2013. Figure 3 describes SKF's value creation tool "Business Excellence", where "Business Excellence Culture" is included as a process to achieve the desired culture. They give actual examples of what is included in the process for instance the "SKF Bridge of Excellence", which they also describe more thoroughly later in the report. This supports the 2p criterion. 3p are earned since they explain the connection between the culture and the value creation.

Business Excellence Culture includes working with values, drivers, mind sets, behaviour and principles

The Business Excellence culture describes how things should be done in order to become more effective and more efficient; and what is expected from leaders. The culture tools include for example the SKF Bridge of Excellence, Pulse meetings and Visual management. The core is involving the whole team and focusing on reducing waste.

The SKF Business Excellence Development team provides training to help an organization start with this way of working and then provides ongoing support via trained Business Excellence Champions.

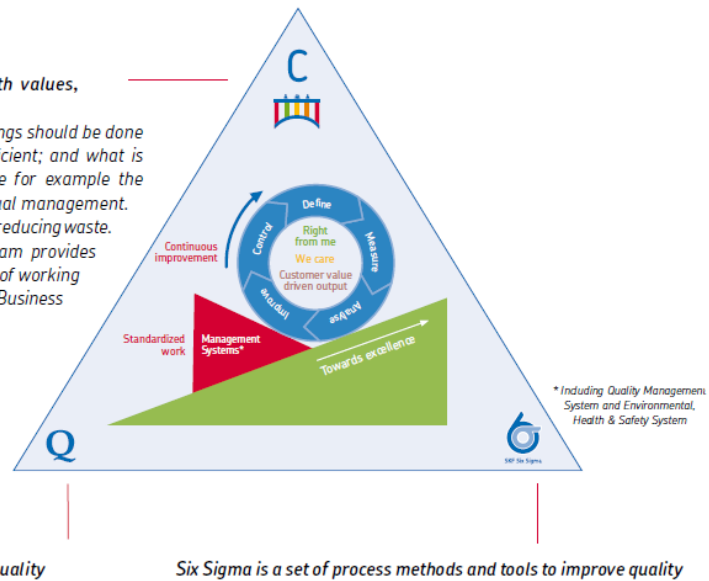


Figure 3: Scoring example of question 2b
(Source: SKF's annual report 2013 p. 29)

Area 3: Actions by the board

3a) Board activities during the year – strategic

0p - Nothing mentioned

1p - Mentions something, generically, that could be the same year after year.

2p - Describes by giving multiple specific, not generic, examples of what has been discussed and actions taken.

3p - Linkage to the ability to create value. What has been discussed on the board is clearly linked to the strategy and there is an explanation of why particular actions have been taken. This can be described in another part of the annual report.

Justification:

The <IR> framework states that the report should explain what actions those charged with governance have taken to influence and monitor the strategic direction of the organization. In order to fully meet the requirement of <IR> this matter should be linked to the organization's ability to create value. It is important to report on activities so that stakeholders, who often are separated from the management in large organizations, know what has happened (Crowther 2002). IIRC states that this explanation provides insight about what the board finds strategically important.

Guidance:

Important in the assessment of this area, both question 3a and 3b, is to distinguish between generically written text and information that can be related to the specific period of time. It is common to find the requested information in the corporate governance report but it may appear in other parts as well. To fulfill the criteria it must be clear that the actions are taken by the board or the committees, which consist of board members. Latour is one of the companies in the study which has received 1p since their presentation of the board's strategic activities is generic, see figure 4. Even though acquisitions are mentioned as discussed on the board and the fact that more information on specific acquisitions from the year can be found in other parts of the Latour report, they do not receive more than 1p since it is not clearly stated that the board has been involved in those specific acquisitions.

The Board has had four ordinary meetings during the year to date, not including the constitutional meeting and two additional Board meetings. Two of the Board members were unable to attend on one occasion and one of the Board members was unable to attend on three occasions. Otherwise there has been full attendance.

The company's auditors attended two Board meetings and presented reports and observations from the audits performed.

Matters dealt with by the Board include strategic changes in portfolio investments, acquisitions and sales of subsidiaries, the company's risk exposure, budgets and forecasts for the subsidiaries as well as a financial review of operations.

*Figure 4: 1st scoring example of question 3a
(Source: Latour's annual report 2013 p.63)*

To gain 2p it is necessary to give at least two specific examples of strategic actions taken by the board. According to the IIRC (2014j) Marks & Spencer's annual report is a good example of how actions by the governance should be disclosed. Figure 5 is taken from their 2013 annual report. Marks & Spencer gives several examples of what has been discussed and actions taken by the board grouped by the main areas of focus. Further down in the report the actions of the different committees are well explained. Marks & Spencer also clearly links some of their actions to the strategy, both in the figure "Board activity 2012/2013" as well as in the surrounding text. According to the scoring system of this thesis the criterion for 3p is met.

Board activity 2012/13

The Board's key priority this year was providing oversight of and challenge to the progress of its strategy to be an international multi-channel, retailer. Key activities for the Board during the year included:

Leadership and employees

- Discussed changes in the composition of the Board and its Committees;
- Considered succession planning and approved the appointment of a new executive director and one new non-executive director.
- Reviewed employee engagement across the business – Annual 'Your Say' survey and quarterly pulse surveys; received updates on initiatives taking place across the Company including the BIG Idea, director presentations, roundtable director discussions and Women in Business forums.
- Discussed and reviewed high potential talent across the business, held non-executive director lunches with successional and high performing senior management.

Customers

- Debated and challenged performance in Womenswear. Received and considered updates on the new GM strategy and initiatives across Womenswear.
- Received regular updates from the Customer Insight Unit on the economic environment, the retail sector, competition and customers.
- Considered and approved the launch of M&S Bank current accounts and an in-store branch network.

Strategy

- Two strategic awaydays:
 - i) October 2012: Reviewed investments in the new supply chain programme, considered the future of multi-channel and shopping channels, reviewed the store modernisation programme and the impact and future development of Plan A. Included visits to Castle Donington distribution centre and Cheshire Oaks store.
 - ii) February 2013: Held in Istanbul, it provided an opportunity for the Board to meet our franchise partner and review, discuss and develop the International strategy.
- Reviewed the new strategy in GM and the structural changes made across Womenswear.
- Considered, scrutinised and approved the Group's three year strategic and operating plan.
- Discussed the ongoing store modernisation programme.
- Debated the property strategy and the impact of multi-channel.
- Reviewed the long term funding strategy for the DB pension scheme.

Governance

- Considered, challenged and identified how we continue to manage and monitor risk appetite;
- Reviewed the formal evaluation of the Board and its Committees in 2013, facilitated internally by the Group Secretary.
- Considered, challenged and approved the optimum capital structure for the business.
- Scrutinised and approved a number of capital spending projects.
- Reviewed and challenged the Group's Treasury policies.
- Provided input into the BIS (Business, Innovation & Skills) consultations on the new remuneration and narrative reporting framework.
- Launched an independent investigation into the Q3 leak and reviewed and discussed the recommendations.

Trust and values

- Reviewed and promoted the business values and culture ensuring that they remain relevant and core to the business.
- Considered the impact of the European wide horsemeat scandal on the food industry and M&S.
- Received updates on the Plan A agenda and reviewed initiatives such as the launch of the Shwopping campaign.

Shareholder relations

- Discussed the Annual Independent Investor Audit undertaken by Makinson Cowell.
- Actively engaged our top 20 shareholders and investor bodies at our annual governance event in June 2012 in which the Board invited discussion on matters of concern.
- Discussed our International strategy with investors in Istanbul.
- Engaged retail shareholders at the AGM.
- Helped protect our shareholders by launching a share fraud awareness campaign.



Figure 5: 2nd scoring example of question 3a
(Source: Marks & Spencer's annual report 2013 p. 43)

3b) Board activities during the year - organization's approach to risk management

0p - Nothing mentioned

1p - Mentions something, but generically, that could be the same year after year.

2p - Describes by giving specific, not generic, examples of how the approach to risk management has been influenced and monitored by the board during the year.

3p - Linkage to the ability to create value. An explanation is provided about the actions of the board concerning its approach to risk management and their link to the strategy is clear. This can be described in another part of the annual report.

Justification:

In the third bullet point of the content element governance in the <IR> framework, it is also included that board activities executed to influence and monitor the organization's approach to risk management should be stated in the integrated report. It is very important to disclose on

how risk is managed, as it is a prominent factor in raising confidence in the market, which reduces cost of capital (Solomon 2010). The GRI-G4 (2013) includes that organizations should report on how risks are identified and dealt with as well as the board's role and actions in reviewing the effectiveness.

Worth noticing is that the <IR> framework contains another content element called "Risks and opportunities". This content element aims to guide companies on how to inform stakeholders about the main risks and opportunities that the company is facing, how these might affect the value creation process and how the company handles them. Question 3b in the scoring system is not to be mistaken for the content element "Risks and opportunities". Question 3b aims to help assess whether an annual report disclose information about what specific actions that has been taken by *the board* and/or *the committees* to influence risk management.

Guidance:

As stated above in the section of guidance in question 3a, it is relevant to distinguish generic text from information that can actually be connected to the reported period of time. 1p is earned by mentioning some sort of action taken by the board to influence the risk management but which is presented in a generic way. The 2013 annual report of Mekonomen provides a typical example of how to earn 1p, see figure 6.

Through its operations, Mekonomen is exposed to exchange rate, credit, interest rate and liquidity risks. Handling of these risks is regulated in accordance with the financial policy adopted by the Board. Credit risk relating to customer commitments is managed, according to central frameworks, decentralised locally. Other risks are mainly managed centrally by Mekonomen's Treasury unit.

*Figure 6: 1st scoring example of question 3b
(Source: Mekonomen's annual report p. 65)*

Mekonomen states that the board is involved in the process of establishing a policy regarding financial risks. Mentioning this type of policy established by the board is enough for 1p. However, the example above is a generically written text, which can be used every year. To earn 2p and 3p additional information regarding at least one specific action is needed. Figure 7 is taken from Marks & Spencer's annual report of 2013 and is one example of how to earn 2p and 3p. Marks & Spencer writes in their governance section about the board's approach to risk management and specifically explains the actions taken and connect it to strategy.

To ensure our risk process drives improvement across the business, the Executive Board monitors the ongoing status and progress of action plans against key risks on a quarterly basis. Risk remains an important consideration in all strategic decision-making at Board level, including debate on risk tolerance and appetite.

Key areas of focus

We continue to drive improvements to our risk management process and the quality of risk information generated, whilst at the same time maintaining a simple and practical approach.

During the year we have focused on a number of key areas:

1. Evolving risk descriptions

As time progresses, the nature of some Group risks is evolving. To ensure we continue to address the most important risks facing the Group at this point in time we have updated a number of risk titles and descriptions. New titles are assigned to **GM product** (2012: Our customers) and **Food safety and integrity** (2012: Food safety). New descriptions are in place for **International** and **Our people**.

2. Action plans for key risks

We continue to assess whether sufficient additional mitigating activities are underway to reduce the net risk position of the Group's key risks. By considering net risk on both a one year and three year horizon, we are able to identify when mitigating activities will result in a tangible risk reduction. We also continue to review the ongoing appropriateness of actions to ensure they are as relevant, timely and measurable as possible.

3. Influence of risk tolerance

Risk tolerance and appetite are important considerations in strategic decision-making at Board level. We also recognise the value in applying the concept of risk tolerance in discussions across all levels of the organisation. It is especially beneficial when determining the nature of mitigating activities and their role in addressing risk likelihood or impact.

Figure 7: 2nd scoring example of question 3b
(Source: Marks & Spencer's annual report 2013 p. 45)

Area 4: Culture

4) Reflection of culture when using and affecting the capitals¹¹

0p: Nothing mentioned on the culture of the company.

1p: Mentions what culture (values and norms) the company is striving for.

2p: Describes the current culture of the company and how it affects how business is conducted.

3p: Linkage to the ability to create value. An explanation is provided about how the culture guides the business and how this in turn supports value creation.

Justification:

The <IR> framework states that the integrated report should include information on how the culture, ethics and values are taken into consideration when capitals are used and affected. In this question ethics and values are included in the definition of culture. Culture was defined in connection with question 2b as accepted ways to behave, norms and values shared in the company. Examples of how culture can affect the business is when choosing to do business in

¹¹ Capitals were defined in section 2.1.3 as resources and relationships used and affected by an organization.

certain areas of the world, or refusing some areas, and when choosing what type of products to develop. According to King III (IoDSA 2009), the board is responsible for ensuring that the culture is consistent with the way business is done.

Guidance:

To further gain understanding of area 4 and how it differs from question 2b, figure 8 is attached below. While question 2b focuses on the implementation of the culture, area 4 aims to assess how the existing culture affects the actions of the company and the company's way of using their capitals.

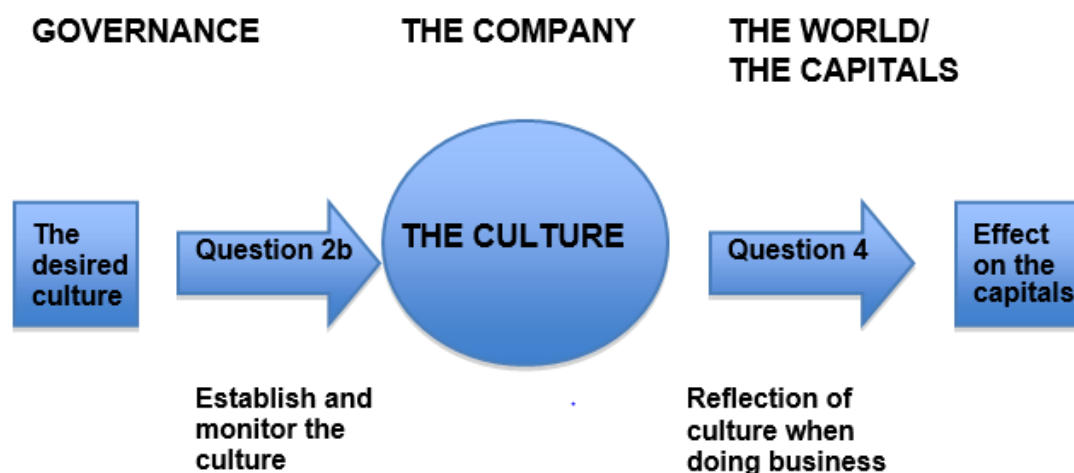


Figure 8: Explanation of the difference between question 2b and 4

To earn 1p it is enough to mention something about the culture of the company. Gunnebo, for example, mentions in the annual report of 2013 their core values and that these values guide the employees in their relations to different stakeholders. For this they receive 1p. 2p is not achieved since it would demand a deeper explanation of the values and more specific examples of how the values guide the employees. TeliaSonera's annual report of 2013 has received 3p. Figure 9 shows the structure of TeliaSonera's group-wide governance framework, which is thoroughly explained in their governance report. The surrounding text clearly elaborates the values and ethics with actual examples of how the values have influenced the actions.

Setting the boundaries for how we act

GROUP-WIDE GOVERNANCE FRAMEWORK – STRUCTURE



Figure 9: Scoring example of question 4
(Source: TeliaSonera's annual report 2013 p. 40)

Scania's annual report from 2013 is another example of how to earn 3p. In the beginning of the report they mention and describe their core values, as a part of their strategy, and these recur throughout the report. Scania gives clear examples of how value is created and the connection to the core values are prominent.

Area 5: Governance practices that exceed legal requirements

Excluded from the scoring system

Area 6: Innovation

6) Responsibility taken by those charged with governance for promoting and enabling innovation

0p - Nothing mentioned

1p - Mentions that innovation is supported in the company in some way.

2p - Describes how those charged with governance take responsibility for promoting and enabling innovation and/or gives examples of how innovation is promoted.

3p - Linkage to the ability to create value. The report explains why those charged with governance take responsibility for promoting and enabling innovation and links it to the organization's strategy.

Justification:

This question is completely based on the sixth guideline in paragraph 4.9 of the <IR> framework. The IIRC (2013a) states that innovation is important for the organization, as it is a value driver, meaning it affects the organization's ability to create value over time. Innovation

can take different forms. It can be product changes, process changes, shifts from satisfying the demand of customers by products to product-services and lastly system changes, which is a broad type of innovation, changing a factor in the foundation of the business, for example the shift from imported agricultural products to locally produced (Ashford & Hall 2011). Lately, companies have realized that sustainability is more than just doing good; focusing on it creates profitable business (Deloitte 2012). A business that is not sustainable does not have a long-term value. Innovation can increase sustainability, by reducing use of energy, chemicals, water and materials and emissions of carbon and waste (Ashford & Hall 2011; Deloitte 2012). Communication on how innovation is supported by the board of directors signals confidence and accountability. The <IR> framework states that the responsibility those charged with governance take for promoting and enabling innovation should be disclosed. Therefore, this was included as a question in the scoring system.

Guidance:

The aim of this question is to help assess whether a company in its annual report communicates how the company and, above all, those charged with governance support innovation and what they actually do to enable innovation. Simply writing that innovation is important does not equal 1p. One must explicitly involve the company and what is done to enhance innovation. Below three examples are included to further express the difference between 0p and 1p.

Mekonomen states in their annual report of 2013 that innovation is important, see figure 10, but nowhere do they mention what they do to make sure the company is innovative. Therefore they do not receive 1p.

Innovation

It is important for the Mekonomen Group to continue to develop new areas which also underpin our core business and that we continue to be innovative. Our new focus areas have developed in different ways. We have had success with our fleet operations, our own brands ProMeister and Carwise, assistance insurance, car insurance, snowmobile parts, Mekonomen Direkt, the ProMeister Academy, proprietary workshops and also with the acquisitions of Sørensen og Balchen in 2011 and MECA in 2012.

Figure 10: 1st scoring example of question 6 (Source: Mekonomen's annual report 2013 p. 5)

Cloetta, on the other hand, gives multiple examples of how innovation is supported. Examples include studies of consumption patterns and consumer panels online. Furthermore, they explain

the process of innovation, see figure 11. One of these would have been enough for 1p if it was clearly linked to innovation. However, 2p cannot be reached without mentioning the board and its responsibility for innovation.



Figure 11: 2nd scoring example of question 6 (Source: Cloetta's annual report 2013 p.14)

SKF is the third example. They write in their annual report of 2013 that they award innovative employees. By disclosing this they achieve 1p.

2p and 3p demands a clear connection to those charged with governance. The 2013 annual report of Saab is a good example of how to achieve both 2p and 3p. In the beginning of the report the chairman of the board talks about the importance of innovation and what is done to enhance innovation. This fulfills the criterion for 2p. Even if the chairman does not explicitly mention what the board has done, the fact that he mentions what the company is doing to support innovation signals involvement and support from the board, and is enough for 2p in this scoring system. Saab has also earned 3p since they link innovation to value creation, by including innovation in the strategy. Many companies might do this, explain how innovation helps create value, but without a clear statement on how the board supports innovation no more than 1p can be earned.

Area 7: Remuneration and incentives

7) Remuneration and incentives' link to value creation

0p - Nothing in the report on why the executives have a certain salary

1p - Mentions that there is a process for determining remuneration and incentives.

2p - Describes why certain remuneration and incentives to the board of directors, CEO and top management are chosen and what they are based on.

3p - Linkage to value creation. The report explains the reason for the remuneration structure. Remuneration and incentives to the board of directors, CEO and top management are linked to performance and execution of the strategy; the use of and effect on the capitals. Both financial and non-financial parameters, in a long-term perspective, are considered.

Justification:

This question is based on the last bullet point in the <IR> framework's content element governance. The use of remuneration to managers based on financial performance is known to bring managers' and shareholders' interest together, reducing agency problems (Solomon 2010). The <IR> framework states that remuneration and incentives should be explained. In this thesis the remuneration and incentives to the board of directors, CEO and top management will be assessed. These should be linked to value creation in the short, medium and long term (IIRC 2013b). The criterion for 3p is based on this as well as the report by KPMG (2012). The report indicates that the remuneration should be linked to delivery of business strategy and value, and this should be explained in the integrated report.

The GRI-G4 (2013) includes several guidelines on the area of remuneration and incentives. These state for example that the report should include the type of remuneration, i.e. fixed or variable pay, how the remuneration and incentives are linked to financial as well as non-financial goals, short-term as well as long-term and the process behind remuneration, i.e. how and by whom remuneration and incentive structures are determined.

The IIRC (2014j) states BHP Billiton and Rio Tinto as two examples that explain the process behind remuneration and incentives in a clear way. This is done through explaining how the structure of the remuneration promotes a good execution of the strategy and how it is measured, informing the reader of what performance is aimed for and how it is rewarded.

Guidance:

The typical way of receiving 1p is to mention the existence of a remuneration committee. 2p requires more details and figure 12 illustrates how to earn it. The text is taken from the 2013 annual report of Scania and describes the purpose of the remuneration as well as what it is based on.

PRINCIPLES FOR COMPENSATION TO EXECUTIVE OFFICERS

The principles for compensation to Scania executive officers are adopted by the AGM. The purpose is to offer a market-related compensation package that will enable the company to recruit and retain executive officers. Compensation to executive officers consists of the following parts:

1. Fixed salary
2. Variable earnings-dependent salary
3. Pension

The fixed salary of executive officers shall be competitive in relation to position, individual qualifications and performance. The fixed salary is reviewed annually. The size of the variable salary is dependent on Scania's earnings. The pension comprises a premium-based pension system that applies in addition to the public pension and the ITP occupational pension.

*Figure 12: 1st scoring example of question 7
(Source: Scania's annual report 2013 p.109)*

To earn 3p the linkage to value creation must be prominent. Mekonomen has in their annual report of 2013 managed to do that, see figure 13.

Remuneration to senior executives

It is extremely important to ensure that there is a clear link between remuneration and the Group's values and financial targets in both the short and the long term. Guidelines established by the 2013 Annual General Meeting fore remuneration to senior executives mean that the company must offer its senior executives market-based remuneration which makes it possible for the Group to recruit and retain the right senior executives, and that the criteria for establishing remuneration must be based on the significance of assignments and employees' competence, experience and performance.

Remuneration shall comprise the following parts:

- fixed basic salary,
- performance-related pay,
- pension benefits,
- other benefits and severance terms



*Figure 13: 2nd scoring example of question 7
(Source: Mekonomen's annual report 2013 p.28)*

In order to receive 2p or 3p the annual report does not have to include enough information on all parts of the remuneration and incentive structure. Information on for example only the remuneration to top management is enough, given that it fulfills the criteria in the question.

Area 8: Statement by the board of directors

8) Statement by the board of directors

0p - No statement by the board of directors

1p - A statement by the board of directors somewhere in the annual report

2p - A statement by the board of directors introducing the corporate governance report

3p - A statement by the board of directors answering all aspects stated in paragraph 1.20 of the <IR> framework

Justification:

This is not included as a guideline in the content element governance in the <IR> framework. However, in the beginning of the <IR> framework (paragraph 1.20, see appendix 3) it is stated as a demand for integrated reporting. Furthermore, when PwC (2013a) assessed how far Swedish large cap companies had come towards integrated reporting, this was one of two questions in the area of governance.

The difference between 1p and 2p has its foundation in an interview with Bo Lagerström¹². According to him it is in the corporate governance report that the statement should be.

Guidance:

One can easily assess whether 0p, 1p or 2p is earned. However the 3p criterion demands insight in paragraph 1.20 of the <IR> framework, which is attached in appendix 3. The basic content of the paragraph is that an integrated report should include a statement from those charged with governance that explains their role and responsibility of the integrated report. Another issue to highlight is if a statement by the board is found outside the corporate governance report, but with a shorter statement introducing the corporate governance report, it has been assessed as enough for 2p. Additionally, if a statement from those charged with governance was found immediately before the corporate governance report it was enough for 2p.

¹² Bo Lagerström, partner and specialist in corporate reporting at PwC, telephone interview February 11th 2014.

Appendix 2 - The scoring table

Name of company: _____

	Question	0p	1p	2p	3p
1a	<p>Composition of the board</p> <p>0p - Nothing mentioned</p> <p>1p - Mentions the characteristics of the board.</p> <p>2p - Describes with a text/info-graphics the diversity and/or gender equality of the current board.</p> <p>3p - Linkage to the ability to create value. There is a discussion on why the board has the chosen composition and how it is linked to the business model.</p>				
1b	<p>Nomination process</p> <p>0p - Nothing mentioned about the characteristics behind the nomination process of the board</p> <p>1p - Mentions that some sort of diversity is one of the goals when choosing new board members.</p> <p>2p - Describes what kind of diversity they are striving for (expertise, competence, gender) and/or gives examples (50% women)</p> <p>3p - Linkage to the ability to create value. The strategy of the nomination committee and/or the suggested board members is in line with the strategy and goals of the organization.</p>				
2a	<p>The strategic decision-making process</p> <p>0p - Nothing mentioned</p> <p>1p - Mentions something on how strategic decisions are taken, the process and what committees there are.</p> <p>2p - Describes more thoroughly where and/or how strategic decisions are taken and how authority is delegated</p> <p>3p - Linkage to the ability to create value by explaining the link between the decision-making process and strategy, future and/or goals.</p>				



		0p	1p	2p	3p
2b	<p>Specific processes used to establish and monitor the culture of the organization, including its attitude to risk and mechanisms for addressing integrity and ethical issues</p> <p>0p - Nothing mentioned</p> <p>1p - Mentions something on how the organization will establish and monitor the desired culture.</p> <p>2p - Describes, more deeply, the process to achieve the desired culture. How does the company ensure that the culture penetrate the company?</p> <p>3p - Linkage to the ability to create value. An explanation on why and how the desired culture will create value and help the organization reach their goals is provided.</p>				
3a	<p>Board activities during the year-strategic</p> <p>0p - Nothing mentioned</p> <p>1p - Mentions something, generically, that could be the same year after year.</p> <p>2p - Describes by giving multiple specific, not generic, examples of what has been discussed and actions taken.</p> <p>3p - Linkage to the ability to create value. What has been discussed on the board is clearly linked to the strategy and there is an explanation of why particular actions have been taken. This can be described in another part of the annual report.</p>				
3b	<p>Board activities during the year - organization's approach to risk management</p> <p>0p - Nothing mentioned</p> <p>1p - Mentions something, but generically, that could be the same year after year.</p> <p>2p - Describes by giving specific, not generic, examples of how the approach to risk management has been influenced and monitored by the board during the year.</p> <p>3p - Linkage to the ability to create value. An explanation is provided about the actions of the board concerning its approach to risk management and their link to the strategy is clear. This can be described in another part of the annual report.</p>				
4	<p>Reflection of culture when using and affecting the capitals</p> <p>0p - Nothing mentioned on the culture of the company.</p> <p>1p - Mentions what culture (values and norms) the company is striving for.</p> <p>2p - Describes the current culture of the company and how it affects how business is conducted.</p> <p>3p - Linkage to the ability to create value. An explanation is provided about how the culture guides the business and how this in turn supports value creation.</p>				



		0p	1p	2p	3p
6	<p>Responsibility taken by those charged with governance for promoting and enabling innovation</p> <p>0p - Nothing mentioned</p> <p>1p - Mentions that innovation is supported in the company in some way.</p> <p>2p - Describes how those charged with governance take responsibility for promoting and enabling innovation and/or gives examples of how innovation is promoted.</p> <p>3p - Linkage to the ability to create value. The report explains why those charged with governance take responsibility for promoting and enabling innovation and links it to the organization's strategy.</p>				
7	<p>Remuneration and incentives' link to value creation</p> <p>0p - Nothing in the report on why the executives have a certain salary</p> <p>1p - Mentions that there is a process for determining remuneration and incentives</p> <p>2p - Describes why certain remuneration and incentives to the board of directors, CEO and top management are chosen and what they are based on.</p> <p>3p - Linkage to value creation. The report explains the reason for the remuneration structure. Remuneration and incentives to the board of directors, CEO and top management are linked to performance and execution of the strategy; the use of and effect on the capitals. Both financial and non-financial parameters, in a long-term perspective, are considered.</p>				
8	<p>Statement by the board of directors</p> <p>0p - No statement by the board of directors</p> <p>1p - A statement by the board of directors somewhere in the annual report</p> <p>2p - A statement by the board of directors introducing the corporate governance report</p> <p>3p - A statement by the board of directors answering all aspects stated in paragraph 1.20 of the <IR> framework.</p>				

Appendix 3 - Paragraph 1.20

1G Responsibility for an integrated report

1.20 *An integrated report should include a statement from those charged with governance that includes:*

- *An acknowledgement of their responsibility to ensure the integrity of the integrated report*
- *An acknowledgement that they have applied their collective mind to the preparation and presentation of the integrated report*
- *Their opinion or conclusion about whether the integrated report is presented in accordance with this Framework*

or, if it does not include such a statement, it should explain:

- *What role those charged with governance played in its preparation and presentation*
- *What steps are being taken to include such a statement in future reports*
- *The time frame for doing so, which should be no later than the organization's third integrated report that references this Framework.*

Source: IIRC 2013b p. 9