

The Impact of Board and Audit Committee Characteristics on the Adoption of Integrated Reporting of Listed Banks in Sri Lanka

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INTRODUCTION

Corporate governance is a systematic way for effective and efficient management of a company. Board of directors are directed and controlled companies on behalf of shareholders of the company. According to the company Act. No. 07 of 2007, board of directors has the responsibility to maintain good corporate governance. Board of directors ought to find the best practices regarding corporate governance and adopt best practices for the successful overall management of the companies. Board characteristics and audit committee characteristics play a vital in corporate governance of the company.

Public interest companies are highly recommended to adopt best practices on corporate governance. Listed banks are Public Interest Companies those companies function directly under the monitoring of central bank of Sri Lanka. According to Colombo stock exchange, there are twelve listed banks. In addition to that, there are local state and foreign commercial banks, specialized

banks, listed and non-listed finance companies and insurance companies. Today, it can be seen that banks, finance companies and insurance companies are providing similar services to customers. Due to that, there is high competition in financial sector of the Sri Lanka and it is considered a highly competitive market.

Further, there are corporate failures and poor financial performance of listed companies in Sri Lanka due to several reasons in last few years. Especially, finance companies are facing corporate failures more in Sri Lanka. Lanka news web (7 April 2019, 01:33 pm) reported that, recent report of the International Monetary Fund (IMF) reported that 15 licensed financial companies out of the 46 licensed financial institutions in Sri Lanka are facing liquidity problems. Especially, range of Non-Performing Loans of six financial companies is between 50 and 90 per cent. Central bank of Sri Lanka revealed that 13 registered financial firms out of 43 registered financial companies in Sri Lanka have collapsed.

Financial institutions are back born of the financial market in Sri Lanka. Therefore, corporate failures should be prevented and avoided for the economic development of a country.

According to the corporate governance best practices, accounting, and auditing standards, management has responsibility to prepare and present the financial statement of the company. Today, most of the stakeholders expect more valuable information for their economic decision making. Therefore, corporate reporting is an essential and valuable communication tool between management and other stakeholders of the company. When corporate reporting from 1960 to present is considered there are several phases of evolution (IIRC, 2011).

Integrated reporting is the latest evolution in the corporate reporting. Organization's strategy, governance, performance and future outlook are

included in the integrated reporting, which connect three key aspects such as commercial, social, and environmental part of the reporting entities. It covers both financial and non-financial information, which provides a clear picture on how an organization creates sustainable value and how a firm applies stewardship. Therefore, integrated reporting is considered as reporting vehicle of the firm.

Companies are motivated to adopt integrated reporting in Sri Lanka as well as in the world. Many companies have adopted integrated reporting to create value and show actual value of the company. Banks are operating in ever-changing and competitive business environment; therefore, they have to create value of their reporting. Generally, board and audit committee play a vital role on every major decision of the company. Adoption of integrated reporting is a major decision and it should be done in the right time. Therefore, this study considers impact of board characteristics and audit committee characteristics on adoption of integrated reporting of listed banks in Sri Lanka. The following research questions will be tested and answered in this study,

Research Questions (RQ)

- RQ₁** : Do board characteristics significantly impact on adoption of integrated reporting of listed banks in Sri Lanka?
- RQ₂** : Do audit committee characteristics significantly impact on adoption of integrated reporting of listed banks in Sri Lanka?
- RQ₃** : Are there any significant relationship among board characteristics, audit committee characteristics, and adoption of integrated reporting of listed banks in Sri Lanka?

Research Objectives

Main objective of the study is to identify impact of board characteristics and audit committee characteristics on adoption of integrated reporting of listed banks in Sri Lanka. The followings are secondary objectives of the study;

- to find out relationship among board characteristics, audit committee characteristics, and adoption of integrated reporting of listed banks in Sri Lanka.
- to reveal the level of integrated reporting adoption of listed banks in Sri Lanka over selected period of the study.

Significance Of the Study

Sri Lanka is a developing country in the world. It is expected to expand its economic activities in local and international business environments. Listed firms contribute considerably amount to the gross domestic production and economic growth of Sri Lanka. Especially, listed banks are critically important for the effective and efficient capital market and financial services to the other firms and citizens of the country. Listed firms have to increase its investment not only in Sri Lanka but also outside of Sri Lanka. Therefore, listed firms have to increase its capital from local and international markets. Sri Lanka attempts to increase foreign investment for the economic development of the country. Here, corporate reporting plays a vital role in the economic decision making of the stakeholders. Traditional reporting gave more priority for the financial information, however, integrated reporting is the reporting vehicle of a company, and it covers both financial and non-financial information. Integrated reporting creates value for the reporting entities through numerous ways. Sri Lankan listed firms also need to create value for their reporting to admire current and future stakeholders. Specially, due to COVID – 19, most of the listed firms face several problems, in this situation there is possibility for

corporate failures. Therefore, listed firms have to sustain their business for a long period of time. Integrated reporting may help to communicate clearly with stakeholders of the company. Board characters and audit committee characteristics are considered as the key in making major decisions of the company. Adoption of integrated reporting is also a major decision for the company. Listed bank is a major sector in Sri Lanka. Therefore, researcher want to carryout research in this new research area to reveal actual relationship among tested variables in this study and to take necessary steps to make regulators change in tested variables for the betterment of the listed banks other companies Sri Lanka. Such initiation may expect to create value for corporate reporting and satisfy expectation of stakeholders from corporate reporting.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Theoretical Review

Board Characteristics

Every company should be registered according to new company act no 07th of 2007 in Sri Lanka. Company is headed by an effective board, board consist directors. Generally, there are two types of directors, executive and non-executive directors. Directors control and direct company on behalf of its shareholders. Board should be appointed according to the provisions of company act. There are several characteristics which are involved in the board of a company. Board size, gender diversity, and independent directors can be considered as key characteristics of a board. There is no mandatory requirement on above characteristics of a board. There are several publications regarding best practices on corporate governance in Sri Lanka. The security exchange commission (SEC) and the institute of chartered accountants of Sri Lanka jointly published very first code of best practices on corporate governance in

2008 to promote good corporate governance practices in the capital market of Sri Lanka. Recently, CA Sri Lanka published code of best practices on corporate governance in 2017. Listed companies are highly recommended to follow code of best practices on corporate governance, however, which are not mandatory in Sri Lanka.

Board Size: It reflects number of directors in the board which may differ company to company. A sufficient number of directors should be needed for the effective and efficient corporate governance of a company. According to new company act no 07 of 2007, a company should have minimum one director to register as a company in Sri Lanka. There is no other mandatory requirement regarding board size of company in Sri Lanka.

Gender Diversity: Gender diversity means that men and women participation in the board and portion of both gender participation in the board. Today, gender diversity plays a significant role in many governance aspects. However, there is no any mandatory requirement on gender diversity in a board of company in Sri Lanka.

Board Independent: Generally, there are two types of directors which are executive and non-executive directors. Executive directors involve in every day operations of the company. Code of best practices on corporate governance - 2017 included several best practices regarding independence of the board. It is expected that board should compose with equal executive and non-executive directors. Board should not be directed and controlled by an individual or a small party which may lead for the unfair economic and non-economic decision making. It is suggested that adequate number of clever and experienced non-executive directors should be included in the board. And also, board should give adequate opportunity and reasonable consideration for non-executive directors' views and involvement in the decision-making process. It is suggested that the board should compose with minimum three non-executive directors or a board

should have comprised of 1/3 of total directors should be non-executive directors whichever is higher, they should also be independent.

Audit Committee Characteristics

Management of the company has responsibility to develop and implement an adequate internal control system in the company. Therefore, public limited companies are highly recommended to have effective and efficient audit committee. There are several audit committee characteristics which may differ company to company. Generally, size of audit committee, number of audit committee meetings, and independent of members are considered as key characteristics of audit committee. Several best practices are highlighted and recommended on audit committee by code of best practices on corporate governance. However, those are not mandatory in Sri Lanka.

Audit Committee Size: Audit committee size means that number of members in the audit committee of the company. Code of best practices on corporate governance – 2017, highly recommended that an audit committee should be composed of majority of non-executive directors with a minimum of three non-executive directors.

Frequency of Audit Committee Meetings: Code of best practices on corporate governance – 2017, highly recommended that minimum four meetings should be held in a calendar year.

Audit Committee Independence: Independence of the committee depends on the number of non-executive directors and their independence in the audit committee. Code of best practices on corporate governance – 2017, highly recommended that audit committee should include at least two independent non-executive directors. There is possibility for more non-executive directors in the audit committee, in such event majority of non-executive directors should be

independent. It is suggested that audit committee should be headed by an independent non- executive director.

Integrated Reporting

Integrated reporting is the latest evolution of corporate reporting in the world. It covers both financial and non-financial information to create value of corporate reporting. The International Integrated Reporting Committee (IIRC) is an international body which covers leaders from several specific areas from corporate, investment, accounting, securities, regulatory, academic, civil society and standard-setting sectors. Integrated reporting framework was developed and published by IIRC in 2013, and consecutively IIRC published revised integrated reporting framework in 2021. Integrated reporting framework has many objectives, the primary objective is to provide guidance to board to communicate information of board effectively and efficiently with its stakeholders to evaluate actual value of the company and make effective and efficient economic decision in the long term perspective with comparability. According to IIRC's integrated reporting framework 2013, eight content elements should be incorporated in integrated reporting. Those eight content elements are organizational overview and external environment, governance, business model, risks and opportunities, strategy and resource allocation, performance, outlook, and basis of preparation and presentation.

According to Act no 15th of 1995, the institute of chartered accountants of Sri Lanka has the responsibility to develop and modify accounting and auditing standards time to time as per requirement of the business environment and issue accounting and auditing standards in Sri Lanka. Accounting and auditing standards are mandatory for public interest companies in Sri Lanka. Public interest companies should follow accounting and auditing standards. Listed banks are public interest companies in Sri Lanka. The institute of chartered accountants of Sri Lanka established a committee to promote and provide

guidance to adopt and practice integrated reporting in Sri Lanka. It is called Integrated Reporting Council, which was formed on 05th of July, 2016 with the support and guidance of the IIRC. Integrated Reporting Council has several objectives, primary objective of the council is to promote integrated Reporting and share adequate knowledge regarding integrated reporting contents, context and implementation with others in Sri Lanka.

Empirical Review

There are many recent studies in this research area conducted worldwide. The following empirical findings are more related to this study. Anis and Indira (2017) examined the effect of audit committee attributes on integrated reporting of 58 listed manufacturing companies in Johannesburg. Multiple regression analysis confirmed that frequency of audit committee meetings and experts in audit committee were significantly impactful on the level of integrated reporting of listed manufacturing companies in Johannesburg. Independence of audit committee did not significantly associate with integrated reporting of listed manufacturing companies.

Simona, Massimo, Ruggiero, and Alfredo (2018) evaluated the effect of board characteristics on practices of integrated reporting in European companies. Researchers considered board size and foreigner in the board under board characteristics. Researchers expected that negative relationship between foreigners' participation in the board and integrated reporting practices. Results of the study confirmed that more than three foreigners in the board have a significant effect to adopt integrated reporting and also feminist culture had a positive effect on integrated reporting adoption in selected companies.

Thilini, Nuwan, and Samantha (2020) investigated corporate governance effect on the integrated reporting quality of public listed companies in Sri Lanka. Statistical analysis of the study clearly reveals that the current corporate

governance system of selected firms supports limitedly to create value through integrated reporting and releasing healthy information to stakeholders of the company. Researchers stated that directors in most of the listed firms give more attention to fulfil mandatory requirements and limited attention to non-mandatory reporting requirements like integrated reporting in Sri Lanka.

Juma, Arafat, Veronica, Bruno, and Zainab (2019) examined effectiveness of audit committee, isomorphic forces and attitude of the management to adopt international financial reporting standards. Statistical analysis of the study reveals that effectiveness of the audit committee, isomorphic forces and attitude of the management contribute significantly to adopt international financial reporting standards in Uganda. Further, the audit committee partially has an impact on between isomorphic forces and adoption of international financial reporting standards.

Muttanachai and Anchalee (2019) examined adoption of integrated reporting in 150 listed companies of Thailand. The study revealed that selected listed companies included 603.59 words of integrated reporting in selected sample period of the analysis. Researchers found that adoption of integrated reporting was increased significantly between 2012 and 2015 in Thailand. Statistical analysis of the study confirmed that firms owned by institution, size of board, corporate responsibility and awards received by the company significantly correlated with adoption of integrated reporting.

Abdifatah and Mutalib (2016) investigated function of the audit committee in the adoption of integrated reporting. According to the results of the study, effective function of audit committee had a significant and positive relationship with integrated reporting practice quality. Authority and meetings of audit committee a significant impact on integrated reporting practice. Even though, audit committee was independent and experts in audit committee did not have a significant on practices of integrated reporting.

Merve and Cemil (2018) evaluated determinants of disclosure regarding integrated reporting through content analysis. According to this study most of the firms tended to issue qualitative disclosure rather than quantitative disclosure. Results of the study revealed that size of firm and gender diversity related positively to forward looking disclosures. However, leverage of the firms was related negatively to forward looking disclosures.

Isabel-Maria, Nicola and Filippo (2020) examined the role of chief executive officer on adoption of integrated reporting. Findings of the study revealed that high level of CEO power opposed to disclose integrated information of the company. High growth opportunities caused CEO to oppose to provide integrated information on the value creation.

Fiona and Martin (2015) examined likely adoption of integrated reporting. Statistical analysis confirmed that medium and low range of links between the majority of reports in the sample, thus limiting their usefulness. According to the findings of the study, experienced managers feel that integrated reporting can bring many advantages to the company than corporate reporting.

Hypothesis Development

According to the depth of literature review, the following hypotheses were formulated and tested in this study;

H₁: There is a significant impact of board size on adoption of integrated reporting of listed banks in Sri Lanka.

H₂: There is a significant impact of gender diversity on adoption of integrated reporting of listed banks in Sri Lanka.

H₃: There is a significant impact of board independent on adoption of integrated reporting of listed banks in Sri Lanka.

H₄: There is a significant impact of audit committee size on adoption of integrated reporting of listed banks in Sri Lanka.

H₅: There is a significant impact of audit committee meetings on adoption of integrated reporting of listed banks in Sri Lanka.

H₆: There is a significant impact of audit committee independence on adoption of integrated reporting of listed banks in Sri Lanka.

H₇: There is a significant relationship between board size on adoption of integrated reporting of listed banks in Sri Lanka.

H₈: There is a significant relationship between gender diversity on adoption of integrated reporting of listed banks in Sri Lanka.

H₉: There is a significant relationship between board independent on adoption of integrated reporting of listed banks in Sri Lanka.

H₁₀: There is a significant relationship between audit committee size on adoption of integrated reporting of listed banks in Sri Lanka.

H₁₁: There is a significant relationship between audit committee meetings on adoption of integrated reporting of listed banks in Sri Lanka.

H₁₂: There is a significant relationship between audit committee independence on adoption of integrated reporting of listed banks in Sri Lanka.

RESEARCH METHODOLOGY

Conceptual Framework

The following conceptual framework clearly shows relationship among board characteristics, audit committee characteristics, and adoption of integrated reporting.

Figure 1: Conceptual Framework

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Operationalization of Variables

Table 1: Operationalization

Key Concept	Variables	Indicator	Measurement
Independent Variables			
Board Characteristics	Board size	Members in the board	Number of members in the board
	Gender diversity	Men and women representation in the board	Number of female members in board.
	Board independent	Non-executive independent directors	Number of non-executive independent directors in the board
Audit Committee Characteristics	Audit committee size	Members in audit committee	Number of members in the audit committee.
	Audit committee meetings	Audit committee meetings	Number of meetings held in financial year.
	Audit committee independence	Independent members in audit committee	Number of independent members in audit committee.
Dependent Variable			
Adoption of Integrated Reporting	Content elements of integrated reporting	Organizational overview and external environment	According to IIRC, there are eight content elements of integrated reporting. How many elements are included out of eight elements in integrated reporting.
		Governance	

	Business model
	Risks and opportunities
	Strategy and resource allocation
	Performance
	Outlook
	Basis of preparation and presentation

Population & Sample

There are twelve listed banks in Colombo stock exchange, all listed banks were considered in this study.

Data Source

It is a quantitative study, relevant data of the study were collected from the published annual report by the respective listed banks in Sri Lanka.

Data Analysis Strategies

Descriptive, regression, and correlation analysis were performed with the help of SATA latest version in this study.

RESULTS AND DISCUSSION

Graphical Presentation

Graph 1: Integrated Reporting Adoption by Listed Banks in Sri Lanka 2016-2020

Above graph shows level of integrated reporting adoption by listed banks in Sri Lanka over the period 2016 to 2020. It was just above 82% in 2016, then rapidly increased and reached to just above 85 per cent in 2017. Then, it slightly increased up to below 86% in 2018, after that it was peaked near 87.5%. It can be seen that the level of integrated reporting adoption has reduced by 1% in 2020, when compared with 2019. Integrated reporting adoption by listed banks increased from 2016 to 2019, then there was slight reduction in 2020. Generally, it is not a good practice, because it is a mandatory to adopt integrated reporting by many countries from 2020. Also, it is difficult to neglect the great impact of COVID – 19 on business practices, performances, and reporting. There are eight key elements in the integrated reporting, which includes future outlook. It is clear that it is very hard to think and include future outlook during this outbreak of COVID – 19.

Descriptive Analysis

Table 2: Descriptive Statistics

According to descriptive analysis, it can be seen that mean value of adoption of integrated reporting is very close to 7 in listed banks in Sri Lanka. It means that listed banks adopted nearly 7 contents out of 8 contents of integrated reporting in Sri Lanka. Listed banks have above 10 members in the board in Sri Lanka, and also it has an average of 1.5 female participation in the board. Those banks have a considerable amount of independent directors, which are more than half

of board size. Nearly 25% of board members are represented in the audit committee of listed banks in Sri Lanka. In addition to that, they have nearly 11 audit committee meetings per annum. Listed banks have significant amount of independent audit committee members, which is nearly 25 per cent of the audit committee size.

Correlation Analysis

Table 3: Correlation

Correlation analysis reveals that there is a significant relationship between female representation in the board and adoption of integrated reporting by listed banks in Sri Lanka. Therefore, H₈ in this study is accepted. Also, independent directors have positive and significant relationship with adoption of integrated reporting, so H₉ in this study is accepted. There is no significant relationship between board size and adoption of integrated reporting, therefore H₇ in this study is rejected. Audit committee meetings and audit committee independent have significant association with adoption of integrated reporting, therefore H₁₁ and H₁₂ in this study are accepted. However, there is no significant relationship between audit committee size and adoption of integrated reporting, so H₁₀ in this study is rejected.

According to above statistical results, chairman, CEO, shareholders, and other regulatory body should motivate more female members in the board, and more independent directors, such necessary action can positively associate with adoption of integrated reporting by listed banks. Also, it is needed for the effective and efficient reporting of financial institution in Sri Lanka. Board size and audit committee size did not significantly associate with adoption of

integrated reporting, Therefore, those characteristics do not seem to have a relationship with integrated reporting of listed banks in Sri Lanka.

Regression Analysis

Table 4: Regression

Based on adjusted R-squared of regression analysis, it can be stated that tested board characteristics and audit committee characteristics have 34.33 per cent of impact on adoption of integrated reporting by listed banks in Sri Lanka. Remaining 65.67 per cent is affected by other factors, which were not considered in this study. Gender diversity, independent directors, and audit committee meetings have a significant impact on the adoption of integrated reporting of listed banks, therefore H₂, H₃, and H₅ are accepted in this study. However, board size, audit committee size, and independent of audit committee have no significant impact on adoption of integrated reporting, thus H₁, H₄, and H₆ are rejected in this study.

Based on the results of regression analysis, top management, stakeholders, and legal authority should consider appropriate level gender diversity, optimum number of independent directors, and more frequency of audit meetings, which can impact positively and significantly on adoption of integrated reporting by listed banks in Sri Lanka. Also, further research is needed to find the impact characteristics of board and audit committee have towards adoption of integrated reporting in Sri Lanka. Future studies can also investigate the impact any other key corporate governance practice has towards adoption of integrated reporting in Sri Lanka. There is no code of best practices on corporate governance regarding women representation in the board and its proportion.

According to this study, female representation in the board has significant impact on adoption of integrated reporting. Therefore, top management, shareholders, and other regulatory body should find appropriate mix of male and female directors in the board for the effective and efficient function and decision making of the board. Also, there is no code of best practices on frequency of audit committee meetings, therefore it is better to develop a code of best practices on frequency of board meetings. It is needed for the effective function of audit committee. Code of best practices on corporate governance 2017, recommends more independent directors in the board, this study also provides evidence for that matter.

CONCLUSION

Integrated reporting is the latest reporting in corporate level reporting, it is believed that integrated reporting creates value to reporting entries through providing financial and non-financial information under specific eight content elements according to international integrated reporting framework by IIRC. Most of the companies are trying to adopt and practice integrated reporting.

Today, entities are operating in ever changing and highly competitive business environment, therefore they have to show their actual value through reporting for the sustainability of entities. Adequate knowledge and awareness are needed to adopt integrated reporting, especially adoption of integrated reporting is a top management decision. Such decision may significantly be influenced by board characteristics and audit committee characteristics of listed firms in Sri Lanka. According to the results of descriptive analysis, it can be seen that listed banks have not adopted all the elements of integrated reporting, which is nearly 7 content elements. Correlation analysis confirmed that gender diversity, independent directors, audit committee meetings, and independent audit

committee have significant relationship with adoption of integrated reporting. According to regression analysis, it can be seen that gender diversity, independent directors, and audit committee meetings have significant impact on adoption of integrated reporting of listed banks in Sri Lanka. Therefore, those banks can improve adoption of integrated reporting through increasing the female representation, securing the independence of the board and audit committee and by holding an adequate number of audit committee meetings. Finally, it can be concluded that listed banks have not fully adopted integrated reporting, which should be encouraged for the sustainability of listed banks in Sri Lanka.

LIMITATIONS OF THE STUDY

The followings can be considered as limitations of the study;

- Researchers focused on one sector out of twenty sectors listed in Colombo Stock Exchange.
- This study covered only five years; from 2016 to 2020.
- Researchers only considered board characteristics and audit committee characteristics among several corporate governance practices of listed banks in Sri Lanka.

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