International Journal of Computer Information Systems and Industrial Management Applications
ISSN 2150-7988 Volume 18(13s) 2026 pp. 1288-1293
https://doi.org/10.70917/ijcisim-2026-4175
Article

Integrated Reporting and Value Relevance: The Moderating Role of Business Ethics

Almotairy Hameed Abdullah[1], Aza Azlina Md Kassim[2]

[1] Graduate School of Management, Management and Science University (MSU), Shah Alam, Selangor, Malaysia.
Email: hqunini@hotmail.com
[2] Graduate School of Management, Management and Science University (MSU), Shah Alam, Selangor, Malaysia.
Email: aza_azlina@msu.edu.my

Abstract: The research explores the importance of business ethics in improving the link between integrated reporting and value relevance. In particular, it states that integrated reporting improves the corporate transparency by means of presenting a consistent picture of value creation based on financial and nonfinancial factors. In its turn, the efficiency of this type of reporting depends on the ethical background and level of transparency of the disclosed information. Using the stakeholder and signaling theories, the author proves that business ethics increases the stakeholders' trust and credibility of disclosure and, therefore, helps to make better investment decisions.

Keywords: Integrated Reporting, Business Ethics, Value Relevance, Stakeholder Theory, Signalling Theory, Disclosure Credibility, Corporate Transparency.

1. Introduction

With the increasing focus of the global business world towards issues of sustainability, transparency, and engagement with stakeholders, companies are not only expected to perform based on financial performance alone but to show evidence of creation of value in the process of dealing with their social and environmental responsibilities . These expectations can be seen in international frameworks for corporate reporting which emphasize responsibility, transparency, and value creation. In line with these trends, the practice of corporate reporting has evolved from merely showing financial statements to adopting more sophisticated means of conveying information about corporate performance .

Within this constantly changing context, the traditional form of financial reporting has been found to be inadequate as a singular process of communicating the value of the organization. Although financial statements remain as one of the main sources of information for the investors, these documents rarely show how the strategy, resources, relationships, sustainability initiatives, and risk management practices can add value to an organization in the long run .

Integrated reporting is generally described as a kind of reporting which illustrates the manner in which the business' strategy, management, performance, and environment combine to create value in the short, medium, and long term. As opposed to conventional forms of reporting, integrated reporting attempts to bring together financial and non-financial information into one single value-creation story. Through presenting a wider picture of the organization's operations, integrated reporting hopes to overcome information dispersion and make organizational reporting more useful.

Increasing integration reporting practice has sparked a lot of academic and professional attention in the area of value relevance impact. Value relevance implies the ability of information provided by an organization to affect the process of decision making by investors and reflect differences in market valuation.

The information is considered value-relevant in the case it helps market participants to assess organizational performance and opportunities for investment. With the growing use of information in capital markets, the quality and integrity of information become vital. However, integrated reporting is not necessarily associated with higher value relevance. The success of the reporting practice is not determined exclusively by the level of disclosure, but also by the integrity of the information. It is possible for firms to disclose a great deal of information but still fail to generate stakeholder confidence in the process if reporting is seen to be largely symbolic or selective. Thus, the integrity of integrated reporting must be considered alongside its ethical context.

Business ethics has therefore become increasingly important as a part of modern-day business reporting. Business ethics involves such things as the norms, guidelines, and values that guide business activities. Organizations that have strong business ethics often provide better disclosures, maintain good communication with all stakeholders, and promote good reporting practices. On the other hand, if the organization lacks appropriate business ethics, the effectiveness of the reporting process will be compromised. This implies that business ethics can no longer be seen simply as a peripheral organizational trait; rather, it should be regarded as a strategy that has the ability to influence the way stakeholders perceive and assess the information provided by integrated reports. Cultures that are ethical make it easier for companies to ensure that the information provided is credible and that the stakeholders will trust corporate communications .

Against this backdrop, the present paper examines the moderating role of business ethics in strengthening the relationship between integrated reporting and value relevance. The central argument of the study is that business ethics provides the credibility foundation through which integrated reporting disclosures are transformed into meaningful and value-relevant market signals. In an increasingly complex business environment, sustainable value creation depends not only on what organizations report, but also on the ethical principles that underpin those reporting practice.

2. Theoretical Foundations of Value Relevance in Integrated Reporting

2.1. Stakeholder Theory and Corporate Accountability

The stakeholder theory can be viewed as one of the main theories that could be applied in analyzing the issue of value relevance in relation to the integrated reporting. The stakeholder theory states that firms have obligations not only to shareholders but also to a wide array of stakeholders such as employees, consumers, suppliers, regulators, community members, and investors. Long-run success depends upon managing these stakeholder relations .

Under the concept of integrated reporting, stakeholder theory suggests that organizations’ disclosures must go beyond traditional financial information in order to provide a holistic view of how these firms are creating, preserving, or destroying value. Integrated reporting facilitates this approach in that it encourages the disclosure of information about strategy, risks, resources, stakeholder management, and sustainability issues. Consequently, through integrated reporting, corporate accountability becomes improved since stakeholders obtain a better understanding of what the firm does and how it creates value .

Value relevance concept is closely connected to the stakeholder theory because the stakeholders are becoming more concerned about non-financial data when considering the performance and prospects of any firm. Information on issues such as sustainability programs, stakeholder relationships, environmental management, and ethics can influence the views held by investors regarding organizational sustainability .

Therefore, disclosure of information related to stakeholders' interests becomes value-relevant for decision-making. The stakeholder theory provides a ready-made link to business ethics. Ethical behavior within the business helps increase stakeholder confidence in the process because it demonstrates that all organizational reports were prepared using an ethical approach. Without strong ethical principles underlying the process, it could simply be considered symbolic rather than being true reporting. In this case, business ethics enhances the validity of stakeholder-focused disclosure practice.

2.2. Signalling Theory and Market Valuation

The signaling theory is another theory used to explain the link between integrated reporting and value relevance. According to the signaling theory, companies voluntarily disclose themselves in order to signal quality, credibility, and future potential to outsiders. As investors often face information asymmetries in judging the organization, disclosures serve to signal and reduce uncertainty. As such, within this structure, integrated reporting functions as a market signal that indicates the strategy of the organization. This is because companies that use their resources in conducting themselves in an open manner with regard to their reporting processes reflect a sense of assurance on how they manage their organizations .

Their success depends on their credibility to a large extent. Investors are more likely to respond to information positively when they feel that it truly reflects the situation within the firm. In this regard, integrated reporting increases the value relevance of information when the information conveyed is seen as credible, comprehensive, and useful . Ethics in business support this communication process through increasing the level of trust that investors will place in the integrity of the disclosed information by companies. Ethical firms will be less likely to practice selectivity or impression management because they are more likely to communicate their information accurately and objectively. Thus, ethics in business support the integrity of signals and increase their effectiveness.

3. Integrated Reporting as a Driver of Value Relevance

3.1. Evolution of Integrated Reporting

The advent of integrated reporting is indicative of a major change in corporate reporting practices. In the past, organizations relied extensively on the use of financial statements to communicate their performance and position. However, rising expectations from investors for transparent information regarding issues like environmental impact, social influence, business strategy, risk management, and creation of value have highlighted the inadequacies of traditional reporting practices .

As a response to these changes, integrated reporting is a reporting model that has been developed with the aim of combining financial and nonfinancial information in a single reporting system. The establishment of the International Integrated Reporting Council (IIRC) is considered to be one of the key milestones in the development of integrated reporting. Over time, since it was introduced, the model has gained increasing international recognition .

Integration in the reporting approach represents the bigger shift towards integration in the way that organizations recognize the interdependency of financial, social, environmental, and intellectual resources in value creation. Integration in reporting does not involve a separate process of sustainability reporting, but is designed to demonstrate the contribution of different organizational resources towards the successful operation of an organization. With the development of reporting structures, there appears to be growing recognition that integrated reporting may prove to be an important tool for improving the quality of disclosures and engaging stakeholders .

3.2. Integrated Reporting and Information Quality

The need for information quality in integrated reporting is based on principles of connectivity, conciseness, comparability, and credibility. According to the IFRS Foundation, the following definition of integrated reporting applies today: "Integrated reporting seeks to improve the quality of information about an organization's strategies, governance, performance and prospects which are useful to providers of financial capital by focusing on communication about value creation; to promote convergence in corporate reporting by facilitating a more connected, concise, clear and balanced report; to foster accountability for creating, protecting and enhancing the social and economic value of an organization; and to encourage integrated thinking in decision making." The reason why information quality is relevant to value creation is that financial markets are not efficient in terms of pricing individual datapoints disconnected from strategies and value creation .

The principles and standards of GRI fit in with the logic of impact assessment based on high quality . The standards allow organizations to communicate their impacts in relation to the economy, the environment, and society in an effective, transparent, and comparable way, whereas the updated Universal Standards, implemented in 2023, improved reporting in this regard. This point is relevant since integrated reporting is more valuable if there is an appropriate level of development of reporting infrastructure, which helps avoid inconsistent information in the process. Indeed, while integrated reporting tells a strategic story and provides the value-creation framework, principles like GRI contribute to higher quality information .

3.3. Integrated Reporting and Investor Decision-Making

Integrated reporting evaluate by the capital markets according to the extent to which it can affect the decision-making process of investors. This evaluation is consistent with the IFRS Foundation's viewpoint that investors are the intended users of the integrated report and that the integrated reporting concept leads to more effective decisions regarding the allocation of capital resources. Convergence of reporting models and sustainability disclosure standards emphasizes this role of integrated reporting even more .

For investors, the benefits of integrated reporting can be simply stated as follows: The greater cohesion provided by such reporting reduces the analytical effort required to interpret piecemeal corporate communications, allowing for a better grasp of the connections between corporate strategy, resources, risk, stakeholders, and sustainability. In this regard, investors will be well-placed to make rational appraisals regarding the resilience, growth, and sustainability of the organization .

There is growing evidence to show that when the information provided is reliable and considered economically significant, investors will rely on nonfinancial information as part of their decision-making process. In the case of studies undertaken concerning the ESG reports of companies, it has been shown that investors react positively to the information available and will often use this information to determine how to allocate their portfolio .

4. Business Ethics as a Strategic Moderating Mechanism

4.1. Conceptualizing business ethics in integrated reporting

Business ethics is defined as the value system, including the set of norms and behaviors that control the process of disclosure's preparation, testing, upgrading, adjustment, and communication. As far as the formalized system of business ethics is concerned, the most reasonable is the IESBA model, namely integrity, objectivity, professional competence and due care, confidentiality, and professional behavior. Such an approach to business ethics is especially important in integrated reporting since it involves a large number of subjective factors such as materiality, connectivity, balancing, exclusion, uncertainty, and future-oriented explanation .

This notion fits well into both stakeholder theory and signaling theory. Within the context of stakeholder theory, ethics adds accountability to integrated reporting not simply through disclosure but by making sure that the report reveals the firm's understanding and management of the impacts it creates on people, nature, and the economy . Within the signaling framework, ethics raises the cost of opportunistic disclosure, hence improving the credibility of the signals. Integrated reports become more valuable in terms of information when external stakeholders trust that the report will reveal negative impacts, trade-offs, and solutions rather than suppress them. The GRI guidelines clearly identify sustainability reporting as a tool of impact reporting in a credible way, while the PRI guidelines emphasize that investors find relevant disclosures about sustainability matters worthwhile.

4.2. Business ethics and disclosure credibility

Disclosure credibility forms the basis of the direct way in which business ethics influence integrated reporting. In this regard, IFRS-based reporting seeks to improve the quality of information provided to financiers of capital, whereas GRI standards work towards increasing transparency by means of credible and comparable impact reporting. Nevertheless, credibility does not lie in format, but rather in how far the organization motivates openness, records assumptions, communicates estimation risk, reports negatives and positives, and challenges proposals that do not present a full picture .

It is here that ethics changes from being merely an abstract notion to an actual process. What is especially useful about the IESBA's NOCLAR concept when it comes to this research is that it provides a vivid example of the way the behavior of people under stress should be ethically correct, their reaction in case of possible wrongdoings is supposed to be an escalation and appropriate action. This approach applies directly to integrated reporting. Reporting prepared in the framework of NOCLAR will certainly contain information about corrections, conflicts, and limitations of reporting .

The recent concerns about misleading claims in the sustainability report in the market and regulatory environment only strengthen the rationale for the credibility issue. The importance of firm disclosure has been stressed by the ESMA as the basis of the investment process and the organization has pointed out that misleading claims about sustainability pose certain dangers. This is an important theoretical concern since the value relevance of the integrated report depends both on the volume of disclosures made by firms and on whether the disclosures made are credible from the users' perspective .

4.3. Business ethics and stakeholder trust

The second main mechanism is trust. This can be achieved by ensuring that an integrated reporting reflects the organization's image as well as its processes of listening, learning, correcting, and responding . In this case, GRI

Standards come into play because such standards force companies to report impacts and material topics that are understandable to various stakeholders including investors, policymakers, civil society, among others. On the other hand, PRI notes that institutional investors are not just involved in ethical rhetoric, as they explicitly require the disclosure of sustainability information as part of the responsible investment process .

Under stakeholder theory, ethics improves trust by making integrated reporting dialogic instead of monologic. Trust builds when companies explain how they determined what matters, stakeholder worries, compromises made, and steps taken to remedy any problems . According to this view, ethics turns integrated reporting into something that carries trust as an accountability tool, as opposed to being simply a way of managing the image. This becomes particularly important in environments where there is growing mistrust about sustainability promises, because silence, stock answers, and unwarranted optimism now carry negative consequences.

5. Recommendations for Strengthening Ethical Integrated Reporting Practices

5.1. Enhancing the quality of integrated reporting

First suggests that the approach to preparing reports entails treating report quality as a process and not merely an end-of-the-year exercise. This involves developing a map detailing how strategy, impacts, risks and opportunities, outcomes, and timelines are connected; aligning sustainability indicators against appropriate standards; and distinguishing actual information from estimates and assumptions. The reason behind this recommendation is quite clear since the IFRS-based reporting model and GRI reporting framework prioritize decision usefulness and credibility. Therefore, well-prepared reports need to be traceable, internally consistent, and comprehensible enough to reduce user interpretation costs.

5.2. Embedding ethical principles into reporting practices

Secondly, ethical values need to be incorporated within the process of reporting. Incorporation of ethical values in the process of reporting refers to having a code of conduct that applies to reporting, documentation of all decisions relating to materiality, procedures that define what needs to be done in case there is any suspicion of omission or misrepresentation of facts, and training for staff who develop narrative disclosures and other disclosures not involving financial figures. NOCLAR is especially useful in this aspect, because it defines the duty to avoid silence about misconduct or false statements .

5.3. Improving stakeholder-oriented disclosure

Third, integrated reporting must be made more explicitly stakeholder focused without losing its focus. The Global Reporting Initiative (GRI) provides the best practical model for meeting this objective. It is necessary that organizations make public: (a) identification of material issues; (b) identification of stakeholder groups involved; (c) issues of concern; (d) response to those issues; and (e) level of incompleteness of performance. In countries like Saudi Arabia, which are being exposed to greater sustainability disclosure requirements due to their participation in the larger market environment, this would mean adapting stakeholder reporting to labour practices, community effects, environmental intensity, and country development objectives.

5.4. Strengthening market confidence through ethical transparency

Lastly, the integrity of the market will be enhanced by companies that communicate not just their successes but also their uncertainties, limitations, and remedies. The process will involve communicating about methodological changes, prior period restatements, the extent of assurance provided, current controversies, and remediation efforts. Ethics communication will improve as users learn about what managers don’t know, what continues to be investigated, and instances where performance goals have not been met. Using signaling theory, the effectiveness of this practice can be seen as highly efficient, given that it is harder to fake optimistic signals than simply providing positive statements. This practice also meets the expectations of investors for sustainable disclosures.

6. Conclusion

The moderating effect of business ethics on the relationship between integrated reporting and value relevance has been explored. Based on the theories of Stakeholder Theory and Signalling Theory, the theory behind the study is that through improved information linkage, information quality, and understanding by investors regarding the process of value creation, integrated reporting contributes positively to value relevance. However, the effectiveness of integrated reporting significantly depends on the ethical environment.

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