Materiali e documenti

Mixing Accounting Regulation and Corporate Accountability in the Era of Non-Financial Information, Intangibles and Digitalization

TOrnado or SUnshine?

edited by
Rosa Lombardi

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PART II

Corporate Disclosure before and after the Non-Financial Reporting Directive (NFRD)

Paolo Conte

1. Introduction

The practice of non-financial disclosure plays a crucial role in providing stakeholders a deep understanding of a company's environmental, social and governance (ESG) performance and impacts. It aims to offer stakeholders a comprehensive view of a company's sustainability practices, ethical behaviour, and long-term value creation beyond financial metrics. While financial accounting metrics capture certain aspects of a company's performance, many valuable resources, such as intellectual resources, are not adequately represented (Beattie et al., 2002; Beattie et al., 2004; Mouritsen et al., 2001b; Petty & Guthrie, 2000; Petty et al., 2006). Therefore, non-financial disclosure fills this gap by shedding light on these important factors.

Moreover, several studies have demonstrated that the disclosure of non-financial information is an effective strategy for gaining, maintaining and repairing a company's reputation (Deegan 2002). By being transparent about their non-financial practices, companies can enhance stakeholders' trust and demonstrate their commitment to sustainable and responsible business practices.

The purpose of this contribution is to examine the impact of the Non-Financial Reporting Directive on corporate disclosure practices. It also aims to provide a deeper understanding of the characteristics of social reporting, environmental reporting, intellectual capital reporting, and reports aligned with the Non-Financial Reporting Directive (NFRD) through the proposition of the literature review.

2. Corporate Disclosure before NFRD

Prior to the implementation of the Non-Financial Reporting Directive, non-financial disclosure was predominantly voluntary as highlighted in several studies (Striukova et al., 2008, Dashlsrud, 2008; Okoye, 2009). This meant that companies had varying levels of commitment to reporting on environmental, social, and governance factors. Some companies recognized the significance of ESG reporting and proactively disclosed non-financial information because their primary concern was potential reputation damage and negative investor reactions in the event of non-compliance (He & Li, 2018; Merkl-Davies & Brennan, 2017). Studies have found that companies engage in Corporate Social Responsibility (CSR) activities to influence their reputation positively (Rothenhoefer, 2019).

On the other hand, many small and medium enterprises (SMEs), especially those not listed, provided limited or no non-financial information. Very likely, this lack of reporting was primarily due to the absence of legal requirements. Furthermore, the non-financial reporting landscape was characterized by fragmentation and inconsistency (Turzo et al., 2022). The absence of standardized frameworks, metrics, and reporting guidelines posed significant challenges for stakeholders to compare and assess companies' ESG performance. As a result, there was a wide variation in the quality and scope of non-financial disclosures across different organizations. Before the NFRD, non-financial disclosure encompassed three distinct documents: Social reporting, Environmental reporting, and Intellectual capital reporting (Russo & Lombardi, 2013). Each of these reports focused on different aspects of a company's performance and impacts, further contributing to the fragmented nature of non-financial disclosure practices.

2.1. Social Reporting

Social reporting primarily focuses on an organization's social impacts and performance (Gray, 2002; Gray et al., 1987, Gray et al., 1996). It encompassed the organization's interactions with various stakeholders, including employees, communities, customers, suppliers, and society as a whole. Within social reporting, a range of topics were typically addressed. These include labor practices, human rights, employee well-being, diversity and inclusion, community engagement, philanthropy, and ethical business practices. By reporting these areas, organizations aimed to provide a comprehensive view of their commitment to social responsibility and their efforts to foster positive social change. It aimed to provide transparency (Yongvanich' et al., 2006) and accountability regarding the organization's social responsibility and its efforts to contribute positively to society (Azzone et al., 1997). It allowed stakeholders to evaluate the organization's alignment with their values.

In summary, social reporting goes beyond financial metrics to shed light on an organization's social impacts and performance, to foster transparency, and accountability, and to give a deeper understanding of the organization's social responsibility and ultimately contribute to the sustainable and ethical practices of the organization.

2.2. Environmental Reporting

Environmental reporting, also known as sustainability or environmental disclosure, focuses on an organization's environmental performance and impacts. It involved reporting on various aspects of the organization's environmental practices, resource consumption, pollution, emissions, and efforts to mitigate and manage environmental risks. By providing transparency on these matters, environmental reporting aimed to allow stakeholders to evaluate the company's environmental responsibility and its commitment to sustainable practices.

Within environmental reporting a wide range of topics were typically addressed. These may include topics such as energy usage, greenhouse gas emissions, water management, waste management, biodiversity, and environmental compliance. Environmental reporting allows companies to demonstrate clear accountability and responsibility for their actions (UNEP, 1994).

Traditionally, companies included information regarding the environmental impact of their operations in their annual reports (Nieminen and Niskanen, 2001). However, in the late 1990s corporations recognized the increasing relevance of environmental information and began to adopt "separate sustainability reports" (Jose, & Lee, 2007, p.311). This shift in reporting practices reflected a growing understanding of the environment as a vital strategic planning area.

In conclusion, environmental reporting serves as a tool for organizations to share information about their environmental performance and impacts. It allows companies to highlight their environmental initiatives, demonstrate accountability and emphasize the importance of the environment in their strategic planning processes.

2.3. Intellectual Capital Reporting

Intellectual capital reporting focuses on an organization's intangible assets and intellectual resources (Chiucchi, 2004). This reporting encompassed various elements including the organization's knowledge, expertise, intellectual property, innovation capabilities, and relationships with stakeholders.

For stakeholders to more fully understand an organization and the effectiveness of its managers, it is therefore essential for the corporate to adequately reflect its intellectual resources, because these knowledge-based resources are used and developed to further the organization's achievements, both in the past and looking to the future (Boedker et al., 2005).

In conclusion, intellectual capital reporting recognized the significance of intangible assets in the knowledge-driven economy. It aimed to measure and report on the organization's intellectual resources, their utilization, and their impact on the organization's performance and value. By providing stakeholders with a comprehensive view of these intangible assets, intellectual capital reporting enhanced transparency and understanding of the organization's strategic capabilities and prospects.

3. Corporate Disclosure after NFRD

Directive 2014/95/EU, also known as the Non-Financial Reporting Directive (NFRD), has had a significant impact on disclosure practices for large companies (exceeding 500 employees) headquartered in Member States from 2017 required to provide a series of social, environmental, and governance statements. The Directive was transposed into Italian law by Legislative Decree 254 of 30 December 2016 (Venturelli et al., 2017, p.1). These companies were required to disclose non-financial information in their management reports. This requirement encompasses a range of areas, including environmental, social, employee, human rights, and anti-corruption matters (Cuomo et al., 2022, p.1).

One of the key objectives of the NFRD is to encourage the use of recognized reporting frameworks, such as the Global Reporting Initiative (GRI) and Sustainability Accounting Standards Board (SASB) or other internationally accepted standards, to guide their non-financial reporting. The use of such standards has lowered the effort required to process the disclosed information, has reduced the risk of misprocessing it, and has limited the adoption of a superficial tick-box approach in the disclosure process (Cosma et al., 2020). These frameworks provided a structured approach to reporting, ensuring comparability of information.

Disclosure regulations, like the NFRD, aim to protect corporate investors and stakeholders by increasing the information available to them, hence allowing them to undertake better decision-making (Easterbrook & Fischel, 1984). The Directive emphasized the importance of materiality assessment, requiring companies to disclose information on matters that are significant to their business and have a direct impact on stakeholders. This approach enables companies to identify and prioritize environmental, social, and governance topics based on their relevance and potential impacts. Furthermore, the NFRD seeks to enhance transparency by requiring companies to disclose non-financial information in a clear, concise, and understandable manner. The information provided should be relevant, reliable, and comparable over time to enable stakeholders to make informed decisions.

It set the stage for increased disclosure of ESG information and encouraged companies to integrate sustainability considerations into their business strategies. Previous studies have indeed shown that disclosure regulation is positively associated with improvements in the metrics used to assess the performance of the regulated practice (e.g. Bennear & Olmstead, 2008; Christensen et al., 2017; Delmas, Montes-Sancho, & Shimshack, 2010). The NFRD applies only to so-called "public interest entities", approximately 11.700 companies across the European Union, including credit institutions, insurance undertakings, or large companies with a balance sheet total of EUR 20 million, or a net turnover of EUR 40 million and an average number of employees of 500 (EU 2014/95).

According to the NFRD, the non-financial report should include a brief description of the undertaking's business model and a description of the policies pursued by the undertaking in relation to ESG matters. Moreover, it should include non-financial key performance indicators relevant to the particular business, across environmental matters, social matters and treatment of employees, respect for human rights, anti-corruption, and diversity on company boards (in terms of age, gender, educational and professional background).

The NFRD was effective from 2017 to 2022 and has been replaced by the Corporate Sustainability Reporting Directive (CSRD). Directive 2022/2464, also known as Corporate Sustainability Reporting Directive (CSRD) builds upon the NFRD requirements and expands the scope of mandatory non-financial reporting. It introduces more detailed reporting obligations and standardizes reporting across the EU. Companies subject to the CSRD will have to report according to European Sustainability Reporting Standards (ESRS). Furthermore, the directive extends the reporting requirements to more companies, including large non-listed companies, and listed small and medium-sized enterprises, approximately 50.000 across Europe. Additionally, the CSRD introduces digital reporting requirements and aims to align with global reporting frameworks such as the Sustainability Accounting Standards Board (SASB). On 5 January 2023, the Corporate Sustainability Reporting Directive (CSRD) entered into force and the first CSRD report of companies in the scope of NFRD is due in 2025 for the financial year of 2024. (EU 2022/2464).

4. Conclusion

Recent years have seen a growing interest in corporate social responsibility (CSR) practices and performance, driven by evolving European legislation. The implementation of the Non-Financial Reporting Directive (NFRD) and subsequent Corporate Sustainability Reporting Directive (CSRD) exemplify the effort to enhance corporate transparency. These regulations aim to enable stakeholders to better assess the non-financial performance of both large and small medium-sized enterprises (SMEs) in Europe. Ultimately, their goal is to encourage companies to embrace responsible approaches to their business operations.

A comprehensive examination conducted in this work highlights the fragmented, non-standardized, and dispersed nature of non-financial reporting before the implementation of NFRD and CSRD. This lack of cohesion made it challenging to compare the environmental, social, and governance (ESG) performance of different companies effectively.

Non-financial information was shared with three separate documents. The social report primarily focused on an organization's social impacts and responsibilities, shedding light on its interactions with stakeholders and its commitment to ethical practices. The environmental report focused on the organization's environmental performance and sustainability practices, providing information about resource usage, pollution, and efforts to mitigate environmental risks. Lastly, the intellectual capital report emphasized the organization's intangible assets and intellectual resources, highlighting its knowledge, expertise, intellectual property, and innovation capabilities.

By integrating these three aspects of non-financial reporting, the NFRD and CSRD aim to establish a more comprehensive and standardized framework. This unified approach enables stakeholders to compare the ESG performance of different companies more effectively across Europe. In summary, the NFRD and CSRD play a crucial role in improving corporate transparency and encouraging responsible business practices. By addressing the fragmented nature of non-financial reporting and promoting a standardized framework, these directives enable stakeholders to assess and compare the ESG performance of European companies more accurately.

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This book aims to explore some perspectives on corporate non-financial information, intangibles, and digitalization offering primary studies, research perspectives, and upcoming studies presented by scholars who also participated in the 2023 To.Su. Workshop mainly based on the results of the research project "Mixing Accounting Regulation and Corporate Accountability in the Era of Non-Financial Information, Intangibles, and Digitalization: Tornado or Sunshine?". The edited book addresses issues related to non-financial and sustainability information, as well as intangibles and digitalization from a business administration perspective.

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