NON-FINANCIAL DECLARATION. THEORETICAL ASPECTS

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Abstract

Upon the changes in the accountancy legislation in the European Union, new requirement of art. 48 of The Accountancy Act regarding publication of Non-Financial Declaration along with Annual Financial Statements was issued with relevance to all companies in Bulgaria having more than 500 employees. This new requirement translated into efforts on the part of these companies to come up with such declarations.

The aim of the current paper is to present an investigation on the theoretical aspects of the non-financial declaration as the author believes that this would facilitate the practical sides of the matter, especially given the lack of internationally accepted standards on it at the present moment.

Keywords: *non-financial declaration, non-financial reporting, environmental reporting*

INTRODUCTION

Business environment is constantly changing, modifying the conditions which companies need to consider in order to be successful [1, p. 10]. Certain global changes in contemporary business such as the increasing importance of services, knowledge, creativity and digitalization create a new type of economy [2, p. 9]

The latest changes in EU accountancy legislation require companies with more than 500 employees to prepare non-financial declaration in addition to their Annual Report on activities. Directive 2014/95/EU lays down the rules on disclosure of non-financial and diversity information by large companies. This directive amends the accounting directive 2013/34/EU. Companies are required to include non-financial statements in their annual reports from 2018 onwards [3]. This requirement has translated in Bulgarian legislation as well. Coming up with non-financial declaration poses the question on how it needs to be prepared and hence – what the theoretical aspects of it are.

In order to answer this question, we need to review the basis of non-financial reporting for the purposes of presenting the performance of an organization.

Non-financial reporting has been gaining momentum in the past twenty years due to a number of factors. Accelerating climate change issues, environmental pollution, and the rise of social responsibility concerns have led to the gradual adoption of a number of voluntary reporting schemes aiming at presenting various aspects of the non-financial performance of organizations. After all, keeping the same course of action cannot lead society to a more sustainable world – new methods are needed to get new results [4].

While financial performance is tangible and can be clearly presented, its principles transparent and in most of the cases non-negotiable, non-financial performance proves to be much more difficult to measure, evaluate and therefore present.

First of all the scope of the non-financial performance needs to be defined. It proves to vary significantly among industries and organizations, depending on their scale. There are a number of reporting initiatives that aim at capturing the most important traits of non-financial performance to at offering some kind of standardization of the ways of reporting.

Non-financial declaration is a type of reporting mechanism through which non-financial performance could be presented at least in its most important aspects for the particular organization. It is an obligatory part of annual financial reporting for companies in the European Union (EU) with 500 and more employees. Thus a large number of firms need to start collecting information on their non-

financial performance in a systematic way so as to be able to compile the declaration when the time for it comes.

THE IMPORTANCE OF NON-FINANCIAL INFORMATION AS THE BASIS OF THE NON-FINANCIAL DECLARATION FOR THE EVALUATION OF AN ORGANIZATION

There has always been a clear consensus in financial world on the importance of purely financial indicators presenting the performance of an organization for the evaluation of its soundness and the perspectives ahead of it. Decision making has traditionally placed utmost significance on producing purely financial indicators which to reveal in a most accurate way the state of an organization. Veysel stresses that conventional accounting stresses on presenting the financial performance and the financial results of the organization [5, p. 96]

Not only decision making within an organization, for the purposes of its management, but also outside of it – on the part of investors, creditors, insurers and other stakeholders have been placing the focus on solely financial parameters. All other aspects of the life of the organization – how it treats its staff [6], whether it uses child labor, how it affects neighboring communities, what is the impact from its activities on the environment, etc. have been considered largely as side issues now having direct influence, if any at all, on its performance.

This has been the dominant theoretical paradigm in finance until recent times when certain significant changes started to take place in the surrounding environment affecting the way organizations perform. One such change is related to climate. Irrespective of the reason for it - whether caused by human activity or a natural phenomenon, climate change is already an indisputable fact. More and more research proves that human activity is affecting it.

Another important phenomenon of our time is massive environmental challenges. They materialize in domino effects of negative events such as air pollution, spreading of diseases such as allergies and respiratory problems, soil and water pollution and the consequent plant and food contamination with harmful substances. These are the so-called ‘global problems of the mankind’ that affect population of the entire planet and the solution of which requires the joint efforts of all governments around world [7, p. 74]. When the normal life patterns of people are affected, demand and supply for various goods and services is respectively changing so as to meet the new needs of customers. Thus business and financial performance of companies are affected as well. Dimitrov states that in the process of evaluation of pension insurance administrator it has to take into account not only financial quantitative indicators but also quality performance and he proposes ten such quality indicators [8, pp. 136, 137].

All these in conjunction with the aftermath of the last global financial and economic crisis placed stress on the importance of various problems related to risk management and information of stakeholders [9, p. 5], and on starting to review financial efficiency in all its applications not only as a numeric value but to analyze it in broader terms [10, p. 98]

Consequently organizations with their way of production and operations patterns slowly, and in many cases, reluctantly, become open to investigating the impact from their activities on the environment [11].

The Annual Financial Statement is the main document through which, as Holmes and Sugdens have stated in 1998, "shareholders and other stakeholders are informed about a company's activities, progress and future plans." Dimitrov supports the paradigm that quality and quantity factors are influencing the financial performance and the evaluation of a company [12, pp. 232-260, 270-296].

However, as stated by Zhelyazkova, assessing the environmental impact of a company's activities requires some changes in the way information is provided in the annual financial statements. Back in 1996, a study by the European Federation of Financial Analysts (EFFA) states that only a small number of investors take into account information about a company's environmental performance when making investment decisions and concludes that this is most likely due to the lack of

standardization with regard to the presentation of this type of information as well as the unification of the ways in which it should be interpreted [13, pp. 117, 118]

Zhelyazkova goes further to say that in 1995, in a document to the European Commission dedicated to environmental issues in financial reporting, the Advisory Forum of Accountants provides information on the definitions, recognition, measurement and publication of information on the environmental performance of companies with a financial dimension. The proposal is to demand the publication of the following information where appropriate [13, p.118]:

- environmental provisions in the balance sheet;
- accounting policy in relation to environmental financial information;
- contingent liabilities relating to the environment;
- capitalized environmental costs;
- fines and other penalties imposed on the company to satisfy third parties as a result of loss or damage from environmental pollution;
- references to the company's environmental statement (if any), etc. [14, p. 3]

For companies, however, compiling records that present data in respect of that part of their business is initially always considered as an atypical and unfamiliar activity– spurs of action, such as green activities or one-off initiatives [15]. Organizations' management is presented with a number of questions, namely:

- what indicators should be collected,
- how to organize the process of this activity,
- what methodology to calculate,
- which organizations could audit these data and
- what standards it will be doing auditing
- what is the risk exposure [16, p. 32]
- what type of insurances must be done according to the climate changes [17, p. 6].

Another important issue is the form in which environmental reporting is being prepared. Here too, there are a variety of practices, as there is no mandatory form under which this should be done.

As Zhelyazkova stresses, environmental challenges are shaping the environment in which business operates [18, p. 617].

Some organizations include environmental reporting in their annual reports, others produce separate annual reports, which they name in various ways - environmental reports, sustainable development reports, corporate and social responsibility reports, where they present the data on environmental reporting. Others reject another approach - the prepared environmental reporting data is presented directly on the organization's website and this is done in addition to an informative, formerly marketing goal - many organizations want to be socially associated with the idea of environmental friendliness and thus attract customers.

What are the positive and what are the negative aspects of different approaches to accountability? The leading positive aspect of the environmental performance report, separated from the main and most important report - the annual financial statement of the organization, is that in this way the information on ecological accountability is differentiated from other financial data, more space is allocated to it , because of the need to compile a complete separate document, a relatively larger amount of information is applied compared to cases where environmental reporting is part of the financial statements. The main weakness of this approach is the need for a team to take care of such a type of report or a consultant to assist the organization.

This complicates and makes the production of a stand-alone report more expensive along with the fact that it engages a lot of internal resource for the organization. For the compilation of such a document it is necessary to have a high level of expertise inside the organization regarding the environmental problems, the impact of the company on it and what precise indicators are relevant for the assessment of this impact.

Also, in order to create and maintain benchmarks, even where guidelines from different organizations involved in such activity are used, there is a need to make a number of attempts to clarify the methodology on which data is collected.

At the same time, if environmental reporting data is presented as part of the annual financial statement (which in this case is renamed in an annual financial and environmental report or similar), then the need to produce detailed information on the organization's environmental performance is eliminated. Reporting is limited to selected indicators, usually in tabular form, accompanied by the presentation of dynamics or their features in concise text. Therefore, more and more organizations are using this approach, and the preparation of a separate document on environmental impact is made by companies that, due to their specific activities and expertise, find it worthwhile. Examples are companies, the direct environmental effects of which are significant, such as the chemical, mining, metalworking, refining industries, as well as the world's largest companies, which do not lack the resources to produce the necessary documentation.

At present, environmental reporting is not mandatory in most countries around the world. Its preparation and maintenance by the individual organizations takes place on a voluntary basis. However, especially large companies in highly developed countries are becoming more and more oriented towards adopting such accountability. In this way, they judge and maintain a reputation among the society that helps them build their overall image and supports their efforts to expand the market share.

NON-FINANCIAL DECLARATION SPECIFICITIES

1. Main non-financial reporting frameworks

The voluntary nature of environmental reporting allows individual companies, as has been said, to choose the ways in which they will carry it out. The world practice in this area knows different voluntary environmental accounting schemes. They are a form of framing, accompanied by guidelines on how to collect information, which indicators need to be compiled, what evidence should be provided by reporting organizations about the validity of the data.

A survey of the Federation of European Accountants, devoted to existing reporting frameworks, highlights the following five frameworks:

1. The Prince of Wales Accounting for Sustainability Project, or as it is known - A4S (from "Accounting for Sustainability");
2. Indicators of the German Association for Financial Analysis and Asset Management (Deutsche Vereinigung für Finanzanalyse und Asset Management) for environmental, social and governance key performance indicators (KPIs for ESG);
3. Sustainable Value Project of the European Academy of Business in Society;
4. The Global Reporting Initiative (GRI) Guidelines for Sustainability Reporting;
5. UNCTAD's guidelines for the development of CSR indicators and documents relevant to them [19].

Herein below a critical review of the first four frameworks is provided. UNCTAD guidelines will be the object of a separate study as they require further in depth attention.

1.1. The Prince of Wales Accounting for Sustainability Project

The Sustainability Reporting Project, or, as it is known, A4S (from "Accounting for Sustainability") was created in 2004 by Charles, Prince of Wales. The aim of this project is to support the implementation of the concept of sustainable development, an integral part of which is also the care of the environment, in the core activities of the organizations or, in the words of the prince himself, in their DNA. For this purpose, financial leaders in individual companies and other institutions are expected to be the engine of change [20, p.26].

The Prince and his adherents support the view that in the modern world the ways in which financial and accounting systems traditionally operate do not adequately meet the realities. This is because they are structured in a way that suggests focusing on short-term financial results, while not taking into account the increasing dependence of financial success on the state of the environment and society. Although some companies are beginning to realize the need for change, the majority of organizations are still far from such an understanding. For this reason, it is necessary to actively work on the reflection of the new realities and on their coverage in all aspects of the activities of the organizations. However, this can hardly be done without having a form of tracking the effect of the effort, so it is necessary to create and maintain adequate accountability standards. For this purpose, with the support of the Prince, work is done with chief financial officers and other financial professionals, accountants, investors and politicians.

In this process, two professional networks, associated with the project - the financial directors and the accounting organizations - play an important role. The first network seeks to influence the change of accounting and reporting practices across companies through the financial directors' lobby. In the second, over 1 million (accounting for two thirds of all) accountants from all over the world are members. The goals of this network are several. On the one hand, using the vast professional potential of its members, it produces a number of opinions that support the technical side of the introduction of sustainable development accountability. On the other hand, it develops different training for accountants so as to be prepared for new types of accountability.

As already mentioned, A4S is guided by the belief that, for the purposes of stakeholders, organizations' accountability should not only cover purely financial information about its performance, but also clearly show how the organization is impacting society and the environment. However, in order for such accountability to be meaningful, it should be placed in the context of the overall strategy, risk assessment and organization presentation. In general, A4S aims to contribute to the fundamental transformation of accountability. This quest is in line with the growing dissatisfaction with the nature of traditional accountability. In many publications and expert opinions, it is believed that, on the one hand, it is too narrow in nature and incomplete, on the other - in many cases it is characterized by unnecessary complexity and volume.

That is why the project is working hard to promote the so-called "integrated reporting", presented in brief in Fig. 1 though an illustration of the International Federation of Accountants (IFAC). The term itself appeared for the first time in 2010 [21, p. 3].

As mentioned above, this accountability is by nature holistic. Asenov clearly points out that the present world functions as a dynamic system, i.e. one whole comprising interconnected elements which influence each other [22, p. 78]. This interconnected ness and mutual influence lead to a number of changes on conventional business environment. As Zhelyazkova points out, not only the effects of those changes are difficult to define and predict, but also predictions are very dynamic [23, p. 66].

The idea is for the data to help its users understand the place the organization that produced it has in society and in the environment. As pointed out by Petkov, the main benefit of such reporting is the possibility to get a clearer idea of long term companies' performance and how the risks that will influence the company will reflect on its business model [24, p. 186].

As a result of the project's efforts, concrete guidelines are also given to accountants and financiers on how integrated reports should be prepared. The purpose of these guidelines is to provide organizations

with a clear and comprehensible method to link their strategic policy stance, financial performance, and environmental, social and business aspects.

Fig. 1. Integrated reporting



Source: International Federation of Accountants. Long Term Value Creation through Integrated Reporting Questions and Answers for Professional Accountancy Organizations (PAOs), <https://www.ifac.org/publications-resources/long-term-value-creation-through-integrated-reporting>

1.2. Indicators of the German Association for Financial Analysis and Asset Management (Deutsche Vereinigung für Finanzanalyse und Asset Management) for environmental, social and governance key performance indicators (KPIs for ESG)

DVFA was established in 1960 as an organization bringing together specialists from Germany working in the field of investment activity. At present, it has more than 1100 members, representing in turn over 400 different organizations - banks, asset management companies, investment companies, consulting firms and other institutions. It is part of an international network of industrial associations and is a member of the European Federation for Financial Analysis and Asset Management, with over 17,000 experts from Europe as well as the Association of Certified International Investment Analysts, covering over 30,000 professionals from all over the world.

DVFA is therefore well placed in the investment community, and thanks to its long tradition, the concentration of highly specialized knowledge and close links with other professional organizations has the capacity to create indicators that are not only meaningful to the stakeholders but also gain wide publicity.

Key performance indicators for ecology, society, and governance have undergone some changes since their original creation so far. Currently their third version is valid since 2010. The document in which they are described was created by DVFA jointly with the European Association of Financial Analysts (EAFA) and is published under the title "Key Performance Indicators for Ecology, Society and governance - guidelines for the integration of environmental, social and governance issues into financial analysis and business appraisal."

The main presumption of the concept that DVFA offers through indicators is that "corporate sustainability focuses both on minimizing environmental, societal and governance risks, as well as on proactive search for ways of using environmental issues, society and management in the portfolio of

products and services it owns." Indicators inherently include issues and topics that reflect the risks and opportunities for the company, but which need to be seen both in terms of their materiality and the ability to be expressed in numbers. Indicators are based on 114 sub-sectors of the main 41 economic sectors presented in the Stoxx Industry Classification Benchmark (ICB). This is the most detailed breakdown within this classification [25].

This in practice means that the organization that has decided to maintain this kind of accountability first has to determine in which of these 114 subsectors it falls and only then start compiling the content of the indicators. When a company has activities in several subsectors, one should consider who the lead is. Then, it is necessary to decide to what level of detail the indicators will be produced.

1.3. Sustainable Value Project of the European Academy of Business in Society (EABIS)

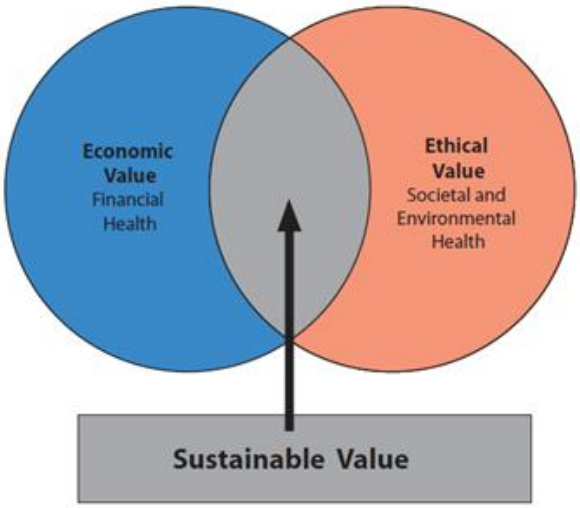
The initiative behind the creation of the Sustainable Value project stems from the European Commission which created the European Alliance for Corporate Social Responsibility in 2006. It is this alliance that organizes the project in order to clarify the specifics of accountability in relation to environmental, social and governance issues and to propose a methodology for its preparation. The members of the academy are actively involved in the project. The Academy itself was established in 2002 and is an association of over 100 institutional members, both from the corporate world and from academic circles. Its purpose is to explore and propose working solutions on how accountability can integrate different aspects of business-to-society relationships.

The specific title of the guidance document on this issue, issued in 2009, is "Sustainable value - a research project of the European Business Academy in Society - CSR, market assessments and measurement of financial and non-financial performance of the company" [26].

The purpose of this project, as defined in the document itself, is to explore the ways in which an organization's performance on environmental, social and governance issues can influence the drivers of its success, how organizations explain these peculiarities to investors, as well as how investors themselves perceive information about them. The document states that research over many years has failed to demonstrate unequivocally that an organization's efforts and achievements in environmental protection, respect for human rights, or improving governance traditions lead to a comprehensive improving its financial position. The report argues that in order to be able to assess objectively the effects of these efforts on the organization, the value created by it must be looked at in a different way from the traditional one so far.

In particular, it is proposed that the results of efforts in the field of environmental protection, community support in various ways, and improved management be viewed as an integral part of the value creation process in the company, which value is proposed to be defined by the term "sustainable value". The thesis is that when taking business decisions into account their environmental, social and governance aspects, the value that is created is more durable than the one that occurs when these aspects are ignored and is thought only in terms of pure economic logic [26]. This thesis has been extended and analyzed by Bansal in the article “Building Sustainable Value through Fiscal and Social Responsibility”, an excellent illustration of which is presented in Fig. 2 below.

Fig. 2. Sustainable Value



Source: Bansal, T. Building Sustainable Value through Fiscal and Social Responsibility, Ivey Business Journal, <https://iveybusinessjournal.com/publication/building-sustainable-value-through-fiscal-and-social-responsibility/>

The main obstacles preventing the adoption and introduction of the concept of sustainable value in company accounts and hence in their accountability may be characterized as follows:

- Owners and managing companies do not believe that potential investors in their business would be interested in information about how the company is working in terms of the environment and society, and exactly what model of management it has chosen.
- Another obstacle in the minds of these persons is the lack of traditions, knowledge and experience within organizations to prepare and maintain such information.
- A third obstacle is that there is currently no uniform standard for how this activity (accounting and / or accounting) is to be carried out.
- As a fourth issue, one can point to the great ambiguity in the terminology related to environmental, social and governance issues and their reporting, which leads to further confusion and reluctance to start tracking their impact on value formation.
- Last but not least, the lack of serious regulatory pressure for the introduction of such accountability over the past years also explains the state of insufficient interest of individual organizations at the moment. Only recently has the EU adopted regulations requiring the large companies (those with 500 employees and above) to disclose non-financial information.

On the other hand, for investors, besides the above mentioned barriers, the problem is also the lack of reporting standards to support comparability of data for different companies, so that this information can be helpful in making investment decisions.

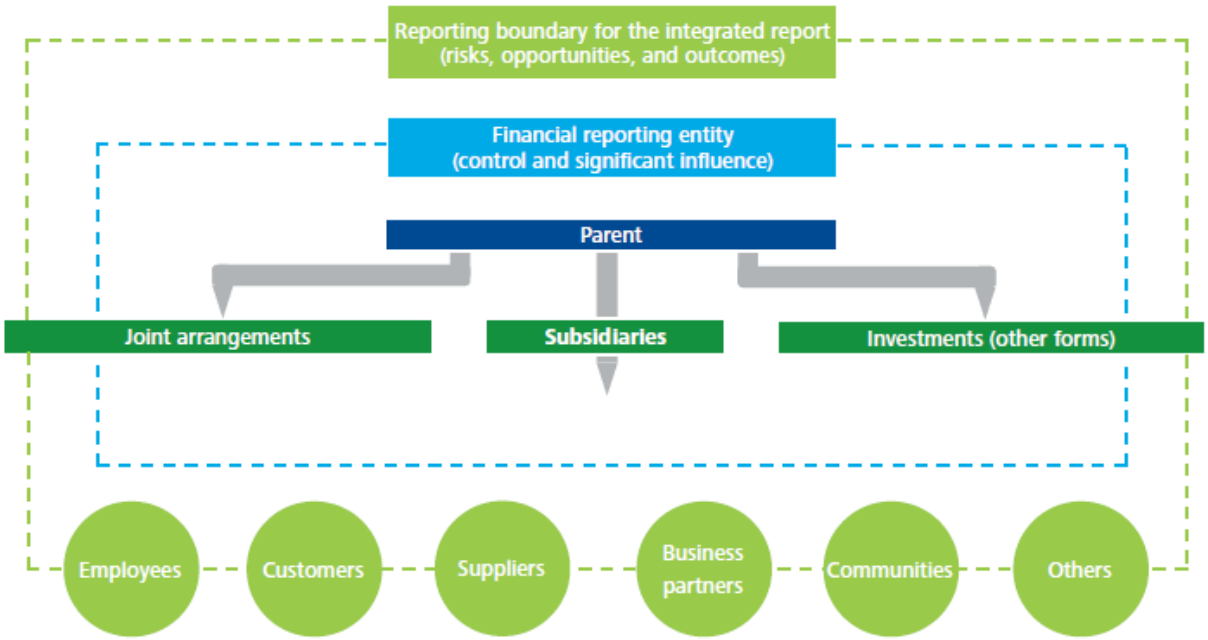
1.4. The Global Reporting Initiative (GRI) Guidelines for Sustainability Reporting

The most commonly used framework of corporate reporting guidelines is that of the Global Reporting Initiative (GRI) [27]. GRI is an international independent organization that originated in the late 1990s to help businesses, governments and other organizations in their efforts to communicate to society the impact their activities have on the environment, climate change changes, corruption and other issues relevant to sustainable development. For this purpose, in partnership with the UN, ISO and OECD, GRI develops specific guidelines that are used to create and maintain accountability across different indicators. These guidelines are currently applied in more than 90 countries around the world and are

used by companies in all areas of economic activity at their request. At present, 93% of the world's top 250 companies provide sustainable development information and 82% compile their reports, following the recommendations formulated in the GRI guidelines.

Reporting on guidelines begins with the definition of the so-called essential or basic aspects and boundaries typical of the company for which the report will be compiled. Essential aspects are considered to be those issues that are of major importance to the organization's activities and on the basis of which the basic decisions are taken [28].

Fig. 3. The Reporting Boundary



Source: Deloitte. Heads Up - IIRC releases the International Integrated Reporting <IR> Framework, <https://www.iasplus.com/en-us/publications/us/heads-up/2013/ir-framework>

The next step is to determine which of these essential aspects have meaning only for the organization, and which - for third parties. This process in the guidelines is called border definition and is essential to assess the effects of the company's business. The GRI Guidelines provide specific guidance on how to do this.

There are two types of reporting according to G4. The first type is common standard reporting, the second type is specific reporting.

Within the first type of reporting, general information is provided about the organization and how the reporting process is structured within the organization. It applies to all organizations, and there are seven types of standard reporting. Each of these seven types is devoted to a part of the organization's activities. Examples of these types are, for example, how the organization deals with ethical issues, what its strategy is to deal with different issues of sustainable development, how staff and other stakeholders are involved in the process, etc. The specific reporting is, in turn, two types. One type covers the organization's management approach, the other type - specific indicators. Taking into account the management approach, information is provided on three things:

1) what are the essential aspects of the organization's activity and why they are considered essential,
2) how the effects are managed, what are the consequences they generate and
3) how they are then evaluated in terms of how successful the management approach has been [13, p.130].

Taking account of the management approach therefore represents a comprehensive overview of the organization's ways and actions with regard to the economic, environmental and social effects of its activities.
Accountability with the use of specific indicators implies that the organization collects, calculates and maintains data about those aspects of its activity that it considers essential.

The G4 guidelines offer a variety of types of indicators on different issues of sustainable development and each organization can choose for its reporting purposes those that it considers relevant to its activity and the information from which it would be useful to the various stakeholders [29].

CONCLUSION

As in the field of environmental accounting and reporting, summarizing information on the representation of organizations on the various environmental issues, there is currently no single framework for all. Non-financial declaration needs to be prepared to a certain extent on the discretion of the companies that need to do this. The lack of a single standard leads, on the one hand, to a number of difficulties in compiling ecological accountability, to doubts among companies' management of how much such accountability is needed, problems in the interpretation of data related to it, especially when comparisons between different companies with investment objectives.
On the other hand, however, at present (2018), a great deal of experience has been accumulated in the development of methodologies for the compilation of ecological accountability. These methodologies generally treat environmental reporting along with two other new types of reporting - those about organizations' activities in terms of society and the governance aspects of their functioning. A number of flagship frameworks have emerged globally, recommending the compilation of such reporting.

Preparing non-financial declaration will slowly, though certainly lead to a gradual establishment of more sustainable business practices as it will place focus on non-financial impact from the activity of organizations. In many cases, this is cost-neutral and can become a source of competitive advantage for companies, operating in various economic sectors [30, p. 582]. Changes, however, need to be internally undertaken, and internal transformation needs to be done in tight collaboration with the external environment [31, p. 339].

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