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Effects on corporate stakeholders and limitations of the implementation of the Non-Financial Reporting Directive (2014/95/EU)

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Abstract

***Research question**:* What are the effects of non-financial reporting (NFR) for companies and stakeholders?
***Motivation**:* We draw on previous research that examines the effects and limitations of the Non-Financial Reporting Directive on key stakeholders.
***Idea**:* This article investigates the increasing significance of the sustainability orientation in corporate operations, as well as the role of NFR in providing information about social, ethical, and environmental aspects of a particular organization. Additionally, the article explores the possible benefits of sustainability reporting, such as improved reputation, in addition to the company's ability to contribute to the sustainable development goals.
***Data and tools**:* This paper provides a scoping review that explores the influence of NFR on the decisions of various stakeholders, such as companies, investors, governments or regulators, accountants and auditors, employees, and the general public. The review discusses existing studies in the literature focusing on NFR and the legislative context in respect to the transition from NFR to sustainability reporting.
***Findings and Contribution**:* This article shows that Directive 2014/95/EU positively influenced the quality and transparency of the sustainability disclosure process of companies. Also, we identify various gaps in the literature, along with challenges faced by firms when reporting on non-financial information and ensuring accuracy and completeness. Based on summarized evidence from the literature, the limitations of NFR include inconsistent formats, lack of standardization, weaknesses in the reliability and comparability of information used in decision-making process, and limited assurance. Finally, our study highlights the importance of transitioning from NFR to sustainability reporting, the latter having significant effects in increasing stakeholder participation, safeguarding business reputation, boosting investor confidence and achieving the

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sustainable development goals, while complying with legislation. It explores the challenges and opportunities linked to NFR (a synonym of ESG reporting) and specifies the necessary components of sustainability reporting frameworks.

Keywords: non-financial reporting, sustainability reporting, Corporate Sustainability Reporting Directive, European Union, ESG performance.

JEL codes: M410

1. Introduction

A mindset focused on sustainability in the day-to-day operations of a business is gradually becoming vital for corporate survival. An increasing number of businesses are aware of the potential benefits that could be gained by doing so. Information regarding the social, environmental, and ethical impacts of a firm is referred to as non-financial information (NFI). By using such information, stakeholders can assess not only the long-term survival of the organization but also the potential risks and opportunities it faces (Venturelli *et al.*, 2022).

A comparative analysis of non-financial reporting (Krištofík *et al.*, 2016) found that it has the potential to meet the needs of stakeholders, improve the company's reputation and brand value, and serve as a tool to achieve sustainable development objectives. These benefits can be gleaned from the fact that sustainability reporting has the role of meeting the needs of various stakeholders. The ability of the non-financial report to satisfy the requirements of stakeholders is the source of numerous positive aspects. NFI disclosures are a lens on environmental, social, and governance aspects (commonly known as ESG), which have become essential components of sustainability reporting over the course of recent years.

In recent years, reporting on topics other than financial performance has become an integral aspect of the reporting process in organizations. This change occurred as a result of the increasing importance of such reporting. Businesses are forced to comply with an increasing number of regulations and standards that require them to disclose information regarding environmental, social, and corporate governance concerns. On the other hand, the quality and assurance of NFI is frequently questioned due to the absence of a defined reporting framework and methodology. This is the case even though NFI is frequently used. Investors, securities regulators, and financial markets are concerned about the NFI's capacity to justify the 'sustainability' attribute of business strategies (Aureli *et al.*, 2020).

Directive 2014/95/EU, also known as the Non-Financial Reporting Directive (NFRD), is an important legislation enacted by the European Union (EU) in 2014. The aim of this directive is to enhance transparency and sustainability in the

corporate sector. It requires large companies ("public-interest entities") to disclose non-financial information, such as environmental impact, social responsibility, and corporate governance practices. The directive emphasizes the significance of integrating ESG considerations into business strategies and decision-making processes. By promoting NFR, the Directive enables stakeholders, including investors, employees, and the public, to gain a comprehensive understanding of a company's environmental and social performance. This directive plays a crucial role in fostering responsible business conduct and promoting sustainable development within the EU.

According to Directive (EU) 2022/2464, environmental considerations for a corporation must take into account its carbon emissions, the quantity of resources it consumes, and the manner in which it handles its waste. Examples of social aspects include a company's interactions with its employees, customers, and suppliers, as well as with communities affected by the activities of that company. Social aspects also include the communities that are impacted by the activities of the company. In the context of an organization's performance and sustainability goals, the phrase 'governance considerations' refers to the administration and monitoring of an organization, including the company's internal controls and regulations. When reporting on topics other than finances, companies must strike a delicate balance between the need to be transparent and the desire to provide information that is relevant to the readers (Venturelli *et al.*, 2022).

A better understanding of the long-term risks and prospects of a company can be achieved by integrating environmental, social, and governance (ESG) factors into finance research (Arif *et al.*, 2022). When assessing the ESG performance of companies, a comparative study of sustainability reporting is an important tool that should be used (Dumitru *et al.*, 2017). By comparing the sustainability reports of various companies, stakeholders can receive insight into how organizations address sustainability concerns, the efficacy of their sustainability policies, and how they compare with their industry counterparts. This can be accomplished by contrasting the numerous sustainability reports submitted by EU-based enterprises (Dragomir *et al.*, 2022a).

Previous studies have not included a literature review of the advantages and disadvantages of NFR for different categories of stakeholders. This is a gap in the literature that the present article seeks to address. The regulatory setting refers to the European Union after 2017, the first year of adoption of Directive 2014/95/EU. The objective of this paper is to identify the effects (positive and negative) and limitations of NFRD implementation, through a review of the literature focused on different stakeholders, such as investors, creditors, companies, governments, regulators, accountants and auditors, employees, and the general public. We contribute to the literature by summarizing the effects of NFRD adoption on the

quality and transparency of the sustainability disclosure process of companies, while describing the Central and Eastern Europe context. Also, we identify and highlight various challenges faced by companies when drafting their NFR and ensuring accuracy and completeness, as well as the importance of transitioning from non-financial reporting to sustainability reporting.

The research method is interpretivist and is based on a scoping literature review. A scoping review allows for mapping the main concepts within a domain by summarizing and disseminating data and identifying gaps in existing literature and sources of evidence to inform practitioners, academics and policymakers (Dinh *et al.*, 2023). Our research methodology provides an overview of the existing evidence on factors that influence non-financial reporting, under NFRD, considering multiple stakeholders. Also, it summarizes studies in the literature, in order to identify the impact of NFRD on reporting specific employee-related topics. Moreover, the scoping review highlights the companies' contribution to the credibility of ESG disclosures, and the way such credibility is enhanced for the general public. Finally, the gaps identified are addressed through the improvements brought by the new Corporate Sustainability Reporting Directive, entering into force starting in January 2024.

The structure of the present research is as follows. Based on a review of the recent literature, this article offers insight into the factors that influence NFR practices among various stakeholders, each discussed in a dedicated section. At the end of the article, we include a presentation of the implications of the new Corporate Sustainability Reporting Directive on the strengthening of sustainability reporting within the European Union.

2. Advantages and pitfalls of NFR for investors and financial institutions

Disclosures related to environmental, social, and governance (ESG) can help financial analysts make better decisions by providing them with information that is helpful for the preparation of profit forecasts (Chouaibi *et al.*, 2021). In the field of sustainable finance, ESG is also considered a fundamental concept. In recent years, an increasing number of investors and analysts have realized the need to factor non-financial considerations into investment decisions, bringing increased attention to ESG factors. These variables include environmental, social, and governance (ESG) factors (Arif *et al.*, 2022). Sustainability considerations are applied to the task of assessing the effects that an organization's activities have on society and the natural environment. Stringent corporate governance standards are also significant for companies, as they represent another factor that is taken into consideration when investing in social and environmental projects, and subsequently reporting their performance (Bigelli *et al.*, 2023). Similarly, in the banking sector,

developing internal ESG assessment criteria and allocating sufficient budgets for this activity (Dragomir *et al.*, 2022b), allow for a proper ESG diagnostic before setting any process that supports NFR.

NFR is able to provide information on how an organization operates in terms of the economic, social, and environmental dimensions of sustainable development. Furthermore, NFR assists the company in creating a comprehensive picture of organizational performance (Venturelli *et al.*, 2022). This can help investors and other stakeholders evaluate a firm's commitment to sustainable practices and the influence that the company has on the community at large. Supplying potential and present investors with accurate and reliable data on a company's non-financial performance can reduce information asymmetry in the capital market. This is accomplished through the process of non-financial reporting and has the potential to make the company more appealing to investors, optimize its financing costs, and raise its value. NFR also has the potential to increase the transparency of company activities, which in turn can increase investor trust (Caputo *et al.*, 2019).

ESG data can be used by financial analysts to recognize risks and opportunities that are not reflected in financial statements. This information is used to adjust future earnings forecasts, taking into account the possibility of regulatory hazards, and to identify investment opportunities. Disclosures about ESG factors can also shed light on the quality of management, the strength of the company's relationships with its stakeholders, and the company's ability to manage social and environmental risks and opportunities. Disclosures of ESG factors provide sustainability information to financial analysts and investors for use in decision making. Financial analysts can have a better understanding of the long-term prospects of a firm and support more educated investment decisions when they incorporate ESG aspects into their analyses (Arif *et al.*, 2022). According to Krištofík *et al.* (2016), investors can consider certain businesses as more attractive investment opportunities when they assess a strong commitment to sustainability. On the other hand, investors will avoid a riskier investment if a business falls behind its rivals in terms of how well it addresses sustainability challenges.

From a practical perspective, the fast fashion industry is widely seen as having a negative impact on the environment, due to significant resources used, pollution and waste, especially post-consumer waste (Dragomir and Dumitru, 2022). A key solution in reducing the environmental impact is represented by the circular economy. This entails that resources are reused, either in the same form or an upcycled/downcycled form, through reintegration in the natural or economic circuit. In the classical linear economy, pollution arises when goods are produced and waste is generated, doubled by economic loss (Ionașcu and Ionașcu, 2018). Innovative technologies and collaborations support the development of a sustainable business model in the fast fashion industry, starting with the design

stage. Further on, the monitoring of chemical processes at manufacturing plants needs to be in place, while certifications and audits are key to enhancing credibility. Moreover, the reuse-and-recycle phase of the circular business model is significantly dependent on consumers' actions, while it is important for companies to take actions in reducing plastic waste, especially in the packaging phase (Dragomir and Dumitru, 2022).

In terms of disclosures, Dragomir and Dumitru (2022) found that companies activating in the fast fashion industry are not keen to publish their circularity targets. This may be because it creates an implicit obligation to increase circularity performance under public scrutiny. Also, their results show that text fragments in relation to upstream stages, such as recycling fibers and materials, textile and material production, are most frequently disclosed in the annual reports. However, downstream stages, such as post-consumer garment collection, and ensuring transparency and traceability in the value chain still need improvements in terms of disclosures.

As banks represent a crucial actor in the financial stability of the global economy, Bătae *et al.* (2020) analyzed the relationship between ESG and financial performance of 108 European banks in 2018 (81 from Developed Europe and 27 for Emerging Europe). One of the classifications is represented by geography, the European countries being grouped in Western, Southern, CEE, and Northern regions. Bătae *et al.* (2020) found that the social performance of Southern European banks is significantly higher than the one of Northern and CEE banks.

In a study on 333 banks located in Europe, America and Asia, Dragomir *et al.* (2022b) analyzed the influence of ESG factors on financial performance during the Covid-19 pandemic. The results revealed a negative influence of banks' environmental performance in 2019 on the return on equity during 2020, highlighting the fact that any preparation actions to enhance ESG performance during the analyzed period could not offset the negative effects of the pandemic crisis.

Similarly, in another study on 39 European banks, analyzed for the period 2010-2019, some ESG dimensions, such as product responsibility and corporate social responsibility (CSR) strategy, are significantly related to financial performance. However, customers and investors that do business with banks or buy their shares tend to overlook other aspects such as human rights, employee relations and community involvement (Bătae *et al.*, 2021). Also, a positive association was identified between emission reductions and financial performance. Conversely, the relationship is negative when it comes to corporate governance quality. This suggests that either tighter governance measures are not well received by market players seeking short-term returns, or more prudent corporate governance may depress profitability trends (Bătae *et al.*, 2021). Similarly, positive correlations

between NFI and return on assets, respectively return on equity, were found for Romanian manufacturing companies, analyzed between 2017 and 2019 (Hategan *et al.*, 2021). Also, Mihai and Aleca (2023) found that, in the case of Romanian companies, the net profit is positively influenced by NFI quality, which was assessed based on the Global Reporting Initiatives (GRI) standards.

Companies may improve their NFI disclosure to attract new capital. This is because the individual ESG pillars (environment, social and corporate governance) and the combined ESG scores are significantly associated with companies' market value (Constantinescu *et al.*, 2021). The value of NFI has increased in recent years for investors and other decision makers who are looking to make informed decisions. Dragomir and Dumitru (2022) emphasize the importance of quantitative and comparable disclosures. However, the lack of uniformity, dependability, and comparability of the NFI presents a problem for the users in question. Researchers such as Ştefănescu (2022) have concluded that the reported information on non-financial factors is not sufficiently comparable or credible, and that there is no universal definition of NFI and no reliable ESG reporting system. Due to the lack of standardization, data comparison and interpretation present challenges for investors and financial analysts.

Businesses do not report all the non-financial data that consumers consider to be necessary, and many companies report data that users do not consider to be relevant. Because of this, it is difficult to compare the performance of different companies in a meaningful way. Aluchna *et al.* (2022) emphasize that the voluntary approach to NFR damages its credibility and can result in inconsistent and insufficient reporting by enterprises. By regulating sustainability reporting, the European Union can help reduce the flaws of voluntary reporting, improve the quality of corporate reports, and boost the legitimacy of corporate sustainability policies. This can also connect the non-financial performance of a firm with the financial outcomes, which can provide investors with a snapshot of the holistic performance of the organization (Zarzycka & Krasodomska, 2022).

To overcome these challenges, companies should conduct their NFR in a more structured format and obtain assurance for their reports. Companies are under increasing pressure from investors, regulators, and securities markets to improve the quality, comparability, and credibility of their NFI. Businesses have a responsibility to report as much NFI as necessary while simultaneously avoiding statements and data that are not relevant or serve a greenwashing purpose (Kurpierz & Smith, 2020). Assessment of double materiality (societal, environmental, and financial impact) is crucial in this regard (Baumüller & Sopp, 2022). This would make the NFI more comparable and reliable, which in turn would boost its utility for investors and other stakeholders (Krištofík *et al.*, 2016).

For investors and other stakeholders, the absence of standardization, dependability, and comparability of NFI is a considerable challenge. A more structured reporting and assurance model is required to improve the quality of NFI and its usefulness. To build a common definition and reporting language for NFI, companies, regulators, and other stakeholders will need to bring together knowledge and technical resources (Venturelli *et al.*, 2022).

3. Companies' contribution to the credibility of ESG disclosures

Recent studies (Arif *et al.*, 2022) claim that environmental, social, and governance (ESG) disclosures act as a tool to reduce information asymmetry, increase investor confidence, and improve organizations' communication with internal and external stakeholders. According to the findings of Aureli *et al.* (2020), the mandatory NFI has the potential to improve both the quality of the reporting and its credibility. It can also limit the use of environmental, social, and governance disclosures as a strategy for legitimation, considering that businesses have a tendency to adjust the GRI indicators to make them fit their own legitimacy needs (Aluchna *et al.*, 2022). According to the NFRD, companies are free to select both the manner in which they disclose information and the subject matter of those disclosures (Ştefănescu *et al.*, 2020). However, ESG measurement has not yet reached an adequate maturity level in order to generate confidence at the market level (Dragomir *et al.*, 2022b).

ESG factors can influence the performance, reputation, and brand value of an organization, all of which have the potential to affect the organization's financial performance. For example, if a company has a poor track record of environmental protection, it can be subject to regulatory fines and reputational harm. Both factors can have a negative impact on the company's financial performance, in the present and in the future (Arif *et al.*, 2022).

Through gender diversity, cultural diversity, a higher number of independent board members, and the presence of a sustainability committee, higher ESG scores are obtained (Bigelli *et al.*, 2023). Moreover, in the study performed on 835 European companies, between 2002-2020, NFRD leads to increased ESG scores as well as reduced ESG gap between companies with and without the creation of a sustainability committee (Bigelli *et al.*, 2023). Conversely, gender diversity and board independence are found to be a negative factor of social and environmental performance, in a study analyzing a sample of 266 companies, for the period 2016-2020 (Mititean, 2023).

Specific recommendations are provided to European energy producers by Dragomir *et al.* (2022c), suggesting increased transparency of corporate disclosures, through enhanced comparability and relevance of information

disclosed on the environmental pillar. Some examples are represented by inclusion of operating and production capacities of renewable energy sources at the level of geographical area, more details in respect of productive assets separated from other investments, and installed renewable energy capacities to be disclosed at the level of each subsidiary (Dragomir *et al.*, 2022c). As climate change mitigation is the core preoccupation of governments (Dragomir *et al.*, 2023), setting measurable targets on carbon reduction is key. On the one hand, if such targets are ambitious and their monitoring is effective, this reflects the effectiveness of public policies. On the other hand, if they are less-ambitious and more oriented on the longer-term, this may indicate that companies do not have a strategic vision to engage in climate transition actions or do not have the necessary resources (people, financial, technological) to engage in such climate change mitigating actions (Blanco *et al.*, 2020). To measure corporate commitment on environmental targets, such as carbon reduction and energy transition, in a study on companies included in STOXX All Europe 100 Index, from various industries, Dragomir *et al.* (2023) proposed a new scoring system of carbon reduction and energy transition strategies. The results show that most targets are medium-term and in absolute values, as recommended by the European Financial Reporting Advisory Group (EFRAG), and some of them had already been achieved, revealing a high degree of institutionalization of carbon reporting (Dragomir *et al.*, 2023).

According to the findings of several studies, environmentally sensitive industries are more likely to provide comprehensive social and environmental disclosure (Aureli *et al.*, 2020; Manes-Rossi *et al.*, 2018). Voluntary NFR, on the other hand, can be a barrier to comparability and can undermine the credibility of ESG data (Aureli *et al.*, 2020). As a result, mandatory disclosure requirements and standards can make it easier for business managers to fulfill their obligations to provide consistent and reliable information to their stakeholders about the company's efforts to address ESG concerns (Arif *et al.*, 2022). According to Krištofík *et al.* (2016), the process of performing due diligence (as stipulated in the European Sustainability Reporting Standard (ESRS) 1, para. 62-63) can be of assistance to firms in determining the areas of their sustainability performance and establishing improvement objectives and priorities. The outcomes of an organization's sustainability efforts can be compared with that of its peers, and the resulting information can be used to determine areas where the organization can improve and develop sustainable strategies. However, if the ESG reporting framework is too vast and complicated, it can cause stakeholders to become confused (Aureli *et al.*, 2020) and miss important information on sustainability.

Significant expenses are incurred throughout the compilation of NFI (Venturelli *et al.*, 2022). Businesses must choose the reporting scope, ratios to disclose, and presentation formats (Krištofík *et al.*, 2016). Doing so is a difficult and time-consuming process. As the pressure on companies to report more NFI increases, it

may become difficult for managers and accountants to strike a balance between the need to disclose information and the desire to maintain a positive image for the company. Companies could also respond to this challenge by disclosing only the positive aspects of their ESG performance while concealing the negative aspects of their performance (Aluchna *et al.*, 2022). This practice has the potential to create an inaccurate picture of a company's performance and undermine the credibility of sustainability reports.

A reporting framework that is too flexible can make it more difficult to achieve harmonization and compare different types of non-financial information (Aluchna *et al.*, 2022). Additionally, regulation alone is insufficient to guarantee the successful and meaningful implementation of rules and standards, since the personal values and beliefs of managers play a significant role in the adoption of practices related to sustainability (Lombardi *et al.*, 2022). The information that is reported would become more consistent and comparable if NFR were mandatory. This could lead to an improvement in the quality of disclosures (Arif *et al.*, 2022). The importance of mandatory disclosure requirements was demonstrated by the slow but steady progress that Romanian companies have been making in reporting and disclosing non-financial sustainability indicators (Beleneși *et al.*, 2021). However, the increase in overall reporting quality after the introduction of mandatory sustainability reporting suggests that such disclosure can be beneficial for companies, their stakeholders, and the environment. NFI disclosures are still voluntary in many countries that are not part of the EU (Arif *et al.*, 2022; Ottenstein *et al.*, 2022).

4. The role of governments and regulators in advancing NFR

The implementation of international standards and norms is performed by key actors, such as the European Commission, as well as local players (i.e. each EU member state) (Albu *et al.*, 2022a). Governments and policy makers play a significant role in the decarbonization process through the requirements they set within the European Union strategies. Regulators are supported by the business environment, and if gaps are identified in corporate non-financial disclosures, public policy is improved. Several practical examples, on multiple industries, are conveyed by Dragomir *et al.* (2023). The authors find that European companies present more carbon reduction targets compared to energy transition targets. This suggests that governments and regulators need to work more on achieving clearer and more comprehensive regulations in the domain of energy transition. Moreover, these actions need to cover the energy efficiency targets, which are scarce in corporate reports. This topic has proved to be significant in the context of the energy crisis accompanying the war in Ukraine (Dragomir *et al.*, 2023).

Positive outlook and reduced financial risk represent the outcome of disclosing high-quality NFI (Radu and Dragomir, 2023). Mandatory disclosure of sustainability indicators has the potential to solve the problem of information asymmetry, to enhance the credibility of ESG data, and to mitigate concerns regarding corporate legitimacy (Beck *et al.*, 2017). Report comparability is an important qualitative attribute of NFI because it supports the development of reporting standards and guidelines at the international, national, industry, or micro level. As a result of this, stakeholders can assess the degree to which companies report on different aspects of sustainability, such as human rights, environmental impact, and corporate governance (Krištofík *et al.*, 2016). This information can then be used to develop sustainability analytics that help stakeholders in sustainable decision making (Beleneși *et al.*, 2021), despite the fact that regulation does not always result in an improvement in NFR quality (Caputo *et al.*, 2019; La Torre *et al.*, 2020).

Researchers have raised concerns about the inefficiency and inability to improve the quality of NFR as required by the NFRD. Ștefănescu *et al.* (2020) argued that the NFRD does not impose sanctions for non-implementation, which may cause businesses to operate in a *de facto* unregulated environment. Furthermore, Caputo *et al.* (2019) discovered that early adopters of the Directive's legal requirements had less compliance difficulties than late adopters. The reporting requirements of the Directive have also been criticized for being static and traditional, and there is no specific guidance regarding which frameworks and guidelines should be used for non-financial reporting. This has led to criticism of the reporting requirements of the NFRD. Samani *et al.* (2023) pointed out that the NFRD and its reporting requirements have a long way to go before they can harmonize NFR and achieve information comparability in Europe. The adoption of a flexible reporting framework (such as the GRI Standards) calls into question the ability of the NFRD to achieve the goal of harmonization and comparability of non-financial information.

To summarize, researchers have advocated for the implementation of mandatory disclosure rules backed by stringent enforcement measures to enhance the quality of NFI. Aluchna *et al.* (2022) argued that if companies were required by law to disclose information related to ESG issues, those companies would limit their reporting practices to the bare minimum required for compliance. Ottenstein *et al.* (2022) found that regulations do not have a significant effect on reporting quality and that the NFRD has not improved reporting quality.

5. The role of accountants and auditors in relation to NFR

EU member states have a key role in the financial reporting field through multiple actions, including tax inspections and education initiatives. These influence

accounting professionals' skills and knowledge. Moreover, at micro level, results show that accountants expect detailed guidance received from the state (Albu *et al.*, 2022a). Investors are increasingly incorporating ESG data into their deliberation processes because they expect that the quality of NFI should be comparable to financial information. To support their investment decisions, they require non-financial information that is of high quality, reliable and comparable. However, in a study analyzing sixteen largest European utility companies for the financial year 2020, Dragomir *et al.* (2022c) found that comparability of financial information related to renewable energy sources is relatively low. This is due to lack of consistency in respect to reportable segments and lack of clarity on formulations regarding investments in renewable energy sources. The importance of NFI in determining whether a company will be resilient and sustainable in the long term has also been recognized by markets and financial regulatory bodies.

One of the many advantages of the NFRD is that it allows stakeholders to conduct comparative analyses of ESG data. This enables companies to evaluate their own performance in relation to that of their industry peers (Krištofík *et al.*, 2016). Integrated reports, which consolidate both financial and non-financial data, are becoming increasingly popular among organizations, which is another advantage. This trend leads to integrated disclosures that are clearer and more concise (Manes-Rossi *et al.*, 2018). Additionally, auditing firms are adapting their service offerings to provide limited assurance in a variety of fields that are outside the scope of the statutory audit (Krasodomska *et al.*, 2021).

However, the NFRD has several drawbacks, the most significant being the absence of standardization in the process of external verification of non-financial statements. This lack of standardization leads to the publication of reports that cannot be compared with one other (Krištofík *et al.*, 2016; Ştefănescu *et al.*, 2020). Additionally, the NFRD does not require stringent disclosure rules or a minimum amount of information to be disclosed, resulting in ambiguity about what constitutes material information (Ştefănescu *et al.*, 2020). A second issue is that the information provided in such reports can be inadequate, inaccurate, biased, subjective, or even manipulative (Caputo *et al.*, 2019).

To mitigate these drawbacks, businesses should seek third-party verification of reported NFI (Krasodomska *et al.*, 2021). This assurance can be helpful in improving the precision, objectivity, and comparability of non-financial reports. Companies are required to disclose sufficient and material information to clear up any confusion that may arise as a result of the lack of stringent disclosure rules in the NFRD. Nevertheless, there is a positive association between assurance obtained on NFI and stock market value, in the case of 660 European listed companies, for the period 2017-2020 (Vander Bauwhede and Van Cauwenberge, 2022). The role of assurance in NFR is emphasized through the actions of the European Commission, which has included a mandatory sustainability assurance requirement

in the new Corporate Sustainability Reporting Directive, which is the successor of NFRD (Vander Bauwhede and Van Cauwenberge, 2022). Before the end of 2024, the final version of the proposed International Standard on Sustainability Assurance (ISSA) 5000 – General Requirements for Sustainability Assurance Engagements, is expected to be issued (IAASB, 2023).

6. Impact of the NFRD on the reporting of employee-related topics

Companies' methods of reporting on employee-related topics have been significantly improved as a result of the NFRD, which was enacted in response to growing concerns about the transparency and accountability of corporations. In particular, Swedish businesses have improved their reporting on employee matters as a response to the directive, illustrating the positive effect that regulatory measures may have in promoting corporate responsibility (Aluchna *et al.*, 2022). Businesses must take a more methodical approach to NFR and related assurance if they intend to keep up with the growing demand. This comprises the creation of a standard reporting framework, the deployment of assurance methods, and the improvement of the quality and comparability of the NFI. In addition to ensuring that their NFI is meaningful to employees, businesses are required to disclose any relevant information in a transparent and accountable manner.

One of the advantages of the NFRD is that it encourages firms to take sustainability-related information into account as part of their overall business strategy and helps raise employee awareness of NFI. This directive also mandates additional risk descriptions to be included in non-financial reports. This is particularly important in circumstances where there is no alternative governance mechanism, such as employee representation, ensuring that employee-related concerns are appropriately considered during the decision-making process (Samani *et al.*, 2023). However, the NFRD may not have the effect that was intended if employees are not effectively represented in governance processes. Substantive measures must be implemented to ensure that employees are fully involved in the reporting process (Samani *et al.*, 2023). This involvement can be encouraged through an appropriate incentive scheme. This would support both employees and companies. Employees would act more proactively in the NFR process, as they are motivated through an appropriate remuneration scheme based on their performance on collecting accurate and complete non-financial data, evaluating and reporting it. With regards to companies, Radu and Dragomir (2023) found that a well-designed compensation system that is linked to sustainability performance leads to diminished financing costs through debt and equity.

7. Central and Eastern European context

Fast economic development is pursued by countries outside the West, while institutional context varies across regions. In Central and Eastern Europe (CEE), the institutional setting of these countries is unique. This is because of the prevailing communist ideology for almost half of a century, followed by the collapse of the totalitarian regimes in the early 1990s and the dramatic transformations also faced by businesses and the macroeconomic environment. There was a conflicting transition from state-owned entities, in charge with social protection responsibilities, simultaneously tainting the natural environment through industrialization, to privately owned companies which were free to pursue their own financial interests. These two periods represent two distinct sets of beliefs and form the basis of communist versus free market ideologies. (Albu *et al.*, 2020).

In terms of the rule of law, government effectiveness and corruption – potentially limiting the quality of corporate governance, Romania ranks low in Eastern Europe (Albu *et al.*, 2022b). However, cultural values influence the emerging social and environmental reporting practices in communist and post-communist Romania (Albu *et al.*, 2020). On the one hand, at the society level, the imprints of the communist ideology, state centrism and primacy of collective good, were transformed into discretionary freedom and profit primacy, in line with the neo-liberal ideology of capitalism. Based on the institutional logics and imprinting combined theoretical lenses, Albu *et al.* (2020) found that discretionary freedom hampered social and environmental reporting and the pursuit of corporate social responsibility. However, over time, such imprints decayed, as a result of various stakeholders' pressures, including the general public and non-governmental organizations.

At organizational level, secrecy and decoupling represent another two imprints associated with communist practices. One of these is represented by manipulating corporate reports when hierarchical superiors had expectations that could not be met in a legal manner, while another was to make no public disclosures. This situation was analyzed by Dragomir *et al.* (2021) in a study of a state-owned enterprise with a deficient corporate governance system. Albu *et al.* (2020) revealed that social and environmental reporting practices were accepted, but were mostly practiced as impressions management. Over time, due to public pressures for transparency, business secrecy slowly decayed in Romania.

8. The improvements brought by the new Corporate Sustainability Reporting Directive

Mandatory NFR represents a key driver for companies to pursue a more robust ESG positioning (Bigelli *et al.*, 2023). Large companies with their headquarters in the EU (with more than 500 employees) were required to report on non-financial information, including ESG factors, in accordance with the 2014/95/EU Directive on Non-Financial Reporting. The newer Directive (EU) 2022/2464, namely the Corporate Sustainability Reporting Directive (CSRD), widened the criteria for mandatory sustainability reporting and made its requirements stricter. The new directive requires that all large companies, regardless of the type of legal structure under which they operate, should report on sustainability aspects. In addition, the definition of large companies has been broadened to include organizations that have more than 250 employees. Small and medium-sized businesses are strongly encouraged to voluntarily report their performance in the domain of sustainability. Listed small and medium-sized enterprises (SMEs) will have the obligation to issue a sustainability statement starting with 2026.

CSRD also establishes reporting requirements that are more specific, such as the disclosure of data on ESG initiatives and outcomes in a predetermined format. Companies are required to report on their ESG policies, due diligence processes, measures, and risks associated with sustainability issues. These issues include climate change, resource depletion, pollution prevention, human rights, employee protection, social issues, and anti-corruption. In addition, the CSRD requires companies to report on their performance in terms of sustainability at the separate (localized) and consolidated levels. This provides stakeholders with a comprehensive view of the companies' performance in terms of sustainability.

The term 'non-financial reporting' has been replaced in the CSRD by the term 'sustainability reporting.' This change is meant to reflect the all-encompassing nature of sustainability reporting, which includes financial and non-financial aspects, closer to the construct of ESG. This change is also a reflection of the growing recognition among stakeholders of the significance of sustainability reporting for the long-term performance of sustainability initiatives undertaken by companies.

Prior to the CSRD, companies were required to disclose their ESG performance prior to the CSRD, but the NFRD lacked specific reporting requirements, guidelines, and methods (La Torre *et al.*, 2020). As a consequence, the NFI provided by EU companies was of varying quality and not comparable, making it difficult for stakeholders to use the information as a basis for decision-making. Furthermore, the lack of specific reporting guidelines (with the exception of the GRI Standards) made it difficult for companies to report information accurately and consistently.

After the amendments provided by the CSRD, the new set of standards issued by the European Financial Reporting Advisory Group (EFRAG) provides in-depth guidelines for reporting on the sustainability of corporations. The inclusion of specific reporting requirements and methodologies helps increase the comparability and transparency of corporate sustainability information. The new set of standards requires businesses to report not only on their ESG performance, but also on their business strategy, risk management, and the financial impact of sustainability policies.

Before the adoption of the CSRD, businesses were not required to obtain independent assurance for their sustainability reports. Businesses were not required to disclose the level of assurance they had obtained or the scope of the audit engagement. This changed after the CSRD was adopted. The process of validating the information contained in sustainability reports and expressing an opinion on the accuracy of that information is referred to as independent assurance and is performed by accredited assurors, including the established audit firms.

There are many different types of stakeholders that are interested in sustainability reporting, including investors, customers, employees, civil society organizations, and regulatory bodies. Investors can evaluate the sustainability performance and associated risks of a company using ESG analytics (Refinitiv, 2022), while consumers can use it to decide what products to buy. The ESG performance of a company is of interest to employees due to its reputational effect (Murè *et al.*, 2021). Civil society organizations and regulatory bodies make use of ESG information to monitor and, respectively, enforce relevant regulations. Information is used by civil society organizations to advocate for issues related to sustainability.

In conclusion, Directive (EU) 2022/2464 provides a comprehensive framework for corporate sustainability reporting. This is achieved by introducing a new set of reporting standards, new assurance requirements, stakeholder participation, and new terminology. Regulators hope that the implementation of these changes will result in increased credibility, comparability, and relevance of sustainability reporting. This, in turn, will enable stakeholders to make decisions based on accurate information and encourage more sustainable business practices.

9. Conclusions

Non-financial reporting, a synonym of ESG reporting, is an indispensable element for businesses that want to increase the transparency and accountability of their non-financial performance. It also contributes to an increased level of disclosure of circular strategies (Hategan *et al.*, 2021) and sustainable business models, more generally. It fosters investor confidence, reduces information asymmetries, and provides a sustainable (green and ethical) orientation for investments. Reporting on

corporate social responsibility should be regulated so that it can help overcome the limitations of voluntary reporting, improve the quality of reporting, and ultimately boost confidence among investors. An overview of the scoping review is presented in Figure 1.

There are multiple interpretations of the company's commitment to environmentally, socially, and economically responsible growth. Caputo *et al.* (2019) emphasize the significance of enhancing the transparency of a company's operations as a means of reducing information asymmetry in the stock market (Aluchna *et al.*, 2022). Additionally, mandatory NFR has the potential to improve the overall quality of sustainability reporting and the company's credibility in the eyes of investors (Aureli *et al.*, 2020). When NFI is included in company reports, it can increase transparency on ESG issues and provide a fuller picture of organizational performance (Sierra-Garcia *et al.*, 2018; Arif *et al.*, 2022).

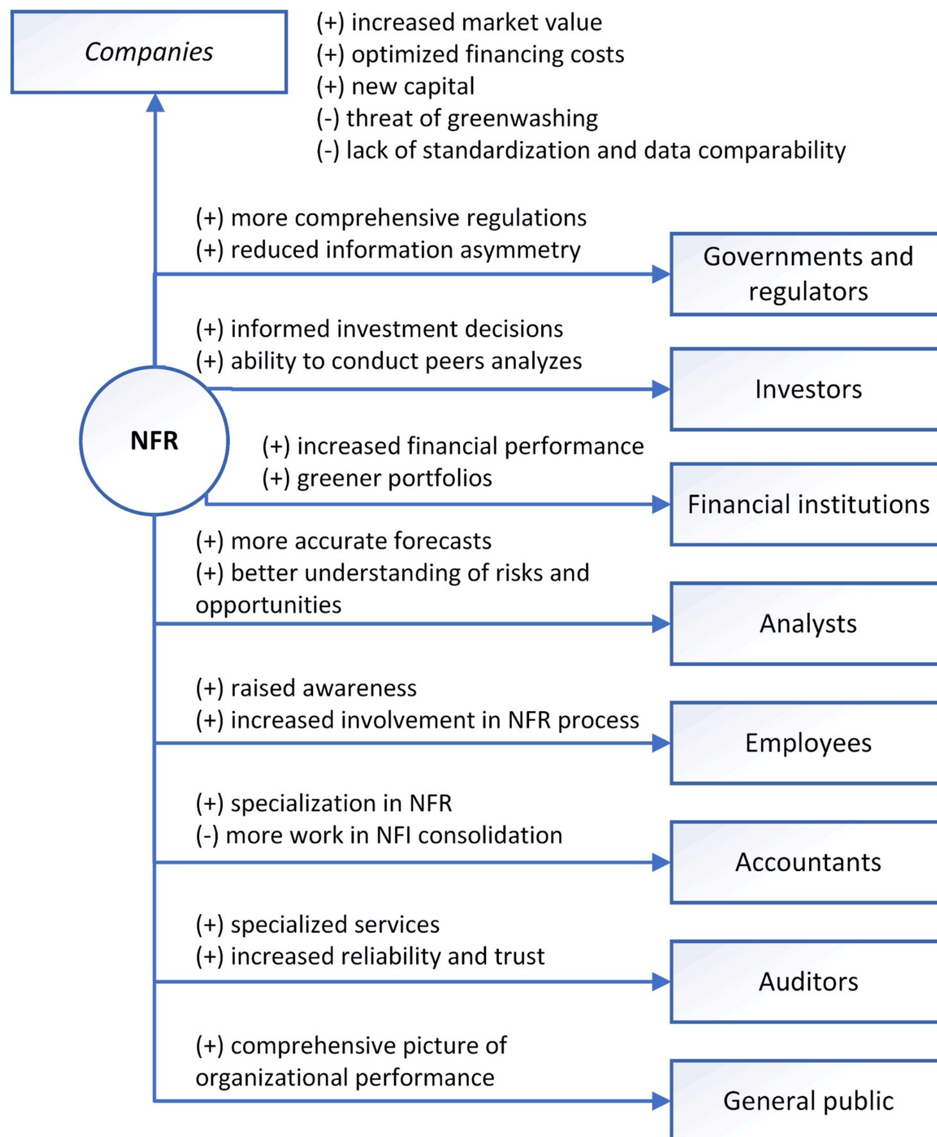

Figure 1. A visual summary of the scoping review concerning NFR

With its extensive history of advancing NFR best practices, GRI can facilitate the transition to sustainability in organizations (La Torre *et al.*, 2020). In addition, the performance and reliability of non-financial reporting policies should be monitored, after data flows are implemented in a specialized non-financial data management system (Mihai & Aleca, 2023). This would increase the transparency of policies, data, responsible owners, processes, controls, outcomes and disclosures. In conclusion, NFR is an essential instrument for enabling

organizational change for sustainability and increasing public awareness, thus elevating the importance of ESG within the organization (Aluchna *et al.*, 2022).

The mandatory regime of the NFRD was a huge step towards increased reporting and transparency on sustainability aspects in business. Despite the fact that there are still some hurdles to overcome, research has shown that the NFRD has had a positive impact on the way companies disclose information related to sustainability (Arif *et al.*, 2022). However, concerns about the effectiveness of the NFRD approach regarding disclosure formats and content support the idea that mandatory reporting standards are necessary. A reform of accounting and reporting centered on accountability is inextricably linked to relevant regulations and a higher-level strategy such as the European Green Deal.

The provision of limited NFI assurance does not guarantee that sustainability information is accurate or comprehensive (Ştefănescu *et al.*, 2020). However, the importance of reporting on matters other than financial performance cannot be overstated. ESG reporting is an essential instrument for companies to illustrate their commitment to environmental sustainability and social responsibility, and also gain trust among stakeholders. However, for NFR to be useful, businesses need to disclose their activities in a transparent and complete manner, providing accurate, timely, and comparable information on how they perform on ESG aspects. In conclusion, NFR is an essential component of corporate reporting and a necessary instrument to promote sustainable and socially responsible business practices.

A potential future improvement for this scientific article would be to conduct a systematic literature review on NFR practices and impacts in the European Union, under a mandatory regime. Adopting a systematic approach can ensure a comprehensive and unbiased assessment of the existing literature on non-financial reporting, acknowledging all pertinent papers in the field. This methodology would involve clearly defining the research questions, establishing inclusion and exclusion criteria, conducting a thorough search across multiple scientific databases, screening and selecting relevant studies, and critically analyzing and synthesizing the findings. A systematic literature review would enhance the rigor and validity of the research, providing a solid foundation for identifying gaps, highlighting key insights, and making meaningful contributions to the field of sustainability reporting.

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