NON-FINANCIAL REPORTING A STRATEGIC ELEMENT IN THE DEVELOPMENT OF ECONOMIC ENTITIES

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Abstract: *Traditional financial reports, as transparency and communication tools of traditional accounting, do not meet the information needs of stakeholders, they only reflect social and environmental aspects to some extent. Shareholders and investors focus more on the long-term impact of the sustainable model. These models can be developed through reports that deal with environmental, social and corporate governance issues. If entities do not publish high-quality non-financial reports, they may soon face evaluation problems during evaluations, as well as problems accessing funding sources and communicating with investors and clients. Starting with the financial sector, capital markets to all economic entities, regardless of the activity sector, non-financial reporting must be subject to strictly defined rules and standards. Each entity must define and report on its strategy, key risks and progress against strategic performance indicators globally. In this context, each economic entity must establish a series of criteria for identifying and prioritizing the targeted gateways, in accordance with the business strategy and reporting method adopted. The main objective of this scientific approach is to analyze the evolution of the financial and non-financial reporting system in order to identify a reporting format, the type of data, information that meets the requirements, taking into account the specifics of the entity, the specifics of the sector in which activates, as well as the information needs of the interested parties. In the second objective, we aimed to achieve the establishment of the threshold of significance and the representation of the most important non-financial aspects by analyzing some well-established variables (the level of influence of the stakeholders regarding the non-financial aspects and the entity's impact on environment, society and economy from the perspective of each non-financial aspect).*

Keywords: *accounting, traditional financial reporting, non-financial reporting, strategic performance indicators, analysis.*
JEL Classification: *M41.*

1. Introduction

Sustainability is an area of increasing interest and scope, and it is imperative that entities pay attention to this area. Sustainability reporting has both short-term and long-term benefits. Also, non-financial reporting requirements are expanding globally, being included in the legislative provisions of an increasing number of countries (de Klerk and de Villiers, 2012). According to the European Union (EU) standard, from January 1, 2017, entities listed on the capital markets with more than 500 employees are required to prepare reports on non-financial information (EU, 2014). Non-financial reporting, also known as sustainability reporting, is the process by which an entity or organization publishes information about the environmental, social and economic impact and performance of its current activities (Ionescu et al, 2020). Non-financial reporting and sustainability also present the entity/organization's values as well as its business model, showing the link between its strategy and its commitment to a sustainable local and global economy.

In Romania, the preparation of non-financial reports is regulated by Order of the Ministry of Public Finance no.1938/2016 by which the EU Directive 95/2014 and the Order of the Ministry of Public Finance no. 3456/2018 were adopted. Therefore, from 2018, organizations are obliged to issue a non-financial report, related to the previous financial year.

The legal obligation to prepare non-financial or sustainability reporting does not mean limiting non-financial and sustainability reporting to only a certain type of entity. Non-financial reporting brings both short-term and long-term benefits to any entity/organization, whether it has 100 employees or 2000.

In the past, financial performance was put first, and nowadays financial institutions know that this aspect only refers to the results of the analysis of some financial indicators. By increasing social and environmental indicators, we are talking about a new value given to performance, which ultimately leads to global performance. The success of the entity involves a combination of economic, social and environmental activities, which must be reflected in the financial reports. An entity's overall audit strategy must consider the financial statements as a whole. Under these conditions, the requirements of ISA 320, the standard that refers to the Threshold of Significance in planning and conducting an audit, are characterized as being relevant and significant in carrying out this scientific endeavor.

Given the growing need for sustainable development globally, the European Commission announced on 21 April 2021 an ambitious and comprehensive package of measures to promote sustainability as part of the objective of creating a neutral Europe from from a climate point of view until 2050. One of the measures was the proposal to develop a directive on corporate sustainability reporting, the aim of which is to improve the flow of sustainability information in the corporate universe for more consistency, so that corporate entities, investors and the general public can use comparable information and relevant in the decision-making process.

The proposed Directive imposes additional reporting requirements compared to the current Non-Financial Reporting Directive (NFRD), with the aim of making sustainability reporting consistent with long-term financial reporting. In addition, the scope of non-financial reporting will be significantly expanded, with estimates indicating that approximately 50,000 economic entities in the European Union will be affected by the new requirements, compared to approximately 11,000 that currently prepare non-financial reports. The sustainability report will include qualitative and quantitative, retrospective and future information. The standards will be different for large entities and SMEs, and the new reporting format could enter into force from 2023 for large entities and from 2026 for SMEs listed on the capital markets of the European Union.

2. Research methodology

The methodology adopted in the present scientific approach is aligned with the research methodology used in the field of economic sciences, by combining theoretical research with empirical research. The present research was based on the study of specialized literature, as well as on practical experiences: financial statements, accounting archives and other non-financial data, made public to identify various thematic areas of reporting compared to the potential value of the studied entity, listed on the Stock Exchange Bucharest values. The paper is based on a deductive approach from general to specific, combining qualitative and quantitative studies.

At the same time, the research methodology used combines quantitative and qualitative research through various complementary methods: historiography, comparison, documentary analysis, graphic representation, statistical estimation, observation, but also public data and materials from financial and accounting institutions, the National Institute of Statistics and the databases regarding the financial and non-financial (sustainability) reports made available by the Bucharest Stock Exchange. To represent practical studies, exploratory research was used.

The theoretical content came to support a better understanding of the economic-financial situation of the entity and represented the scientific basis of the entire process. Qualitative research had as its fundamental element the interpretation method to evaluate the flow of information regarding the entity used as an example. Thus, the form of "observation-deduction" reasoning was adopted, trying to draw a conclusion starting from the existing theories and studies in the field and continuing with empirical investigations based on a content analysis of financial and non-financial reports and statements published by a Romanian economic entity that produces and sells fertilizers, insecticides and fungicides.

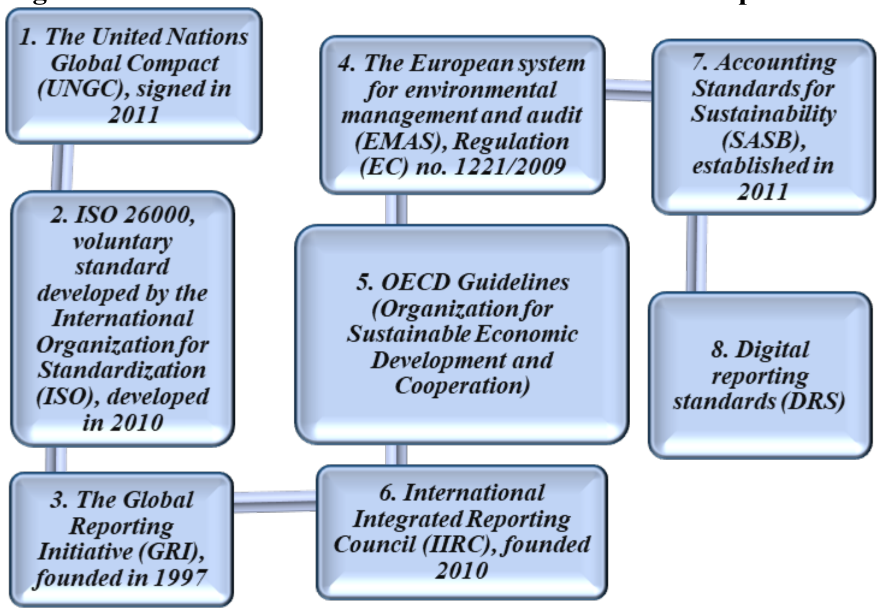
Being a listed entity on the capital market, these reports are publicly exposed and present a significant public interest for various interested parties, thus leading to an increase in the relevance of the information provided. According to the European Directive, those entities with more than 500 employees come into discussion. Also, in Romania and not only, listed entities report more information than non-listed entities due to public exposure, the requirements of information users and especially of capital market investors, interested in financial and non-financial information of the entities in which they can become shareholders. So the relevance of this scientific approach is greater in the case of listed entities. As such, consideration of listed entities is warranted.

3. Analysis and evolution of financial and non-financial (sustainability) reporting systems in order to identify a reporting format

The sustainability policy has an essential role in transforming the way of business to respond to the new socio-economic realities, but also to find a new strategy to support the commitment to become a circular business by the year 2030. To achieve sustainability and decarbonization it is necessary of transition, a technology suitable for current requirements and innovation, as well as the development of the financial side, talent and cooperation with business partners. In this case, each financial institution must establish a series of criteria for the identification and prioritization of interested parties, in accordance with the adopted business policy and strategy and reporting method.

For all this, entities can use national, EU or international frameworks, widely recognized and of high quality (Figure no. 1.), when preparing the non-financial/sustainability statements. Some frameworks cover a wide variety of sectors and thematic aspects (horizontal frameworks), others are sector or thematic specific. Some focus exclusively on the publication of non-financial information, others refer to transparency in a broader context. Typically, the use of a widely recognized framework, developed through appropriate processes, provides entities with structured models for reporting material items of broad interest, makes reporting unburdened, and facilitates the comparison of information.

Figure no. 1. Non-financial (sustainability), national, European or international reporting frameworks in which economic entities can choose to provide information



Source: authors' projection, adapted from the Communication of the Commission-Guidance on the reporting of non-financial information (non-financial information reporting methodology), Official Journal of the European Union, (2017/C 215/01).

Note: *Digital reporting standards can become a strong element in the technical dimension of creating reports that incorporate financial and non-financial data.

**OECD is the successor to the former Organization for European Economic Co-operation (OECE), founded in 1948 to implement the US-funded Marshall Plan for the reconstruction of the European continent after the Second World War. The convention that established the transformation of the OEEC into the OECD was signed on 14 December 1960 in Paris and entered into force on 30 September 1961.

Regardless of the choice, declaration or report, entities are required to submit this information within a maximum of six months from the end of the previous financial year. In addition to the situation where there is a legal obligation to make this disclosure, sustainability reporting may be expressly requested by customers or suppliers, as well as other interested parties with whom the entity has a business relationship.

It should be borne in mind that large multinational entities with well-defined sustainability concerns tend to choose business partners who align with the same concerns, and sustainability reporting itself is a step in this direction. At the same time, through the sustainability reporting of their collaborators, large entities can quantitatively assess the environmental impact of their products throughout the supply chain, for example by calculating the emissions produced by the transport of raw materials. Thus, sustainability reporting can become a mandatory criterion for collaboration with such an entity.

In any of the cases listed in Figure no. 1, sustainability reporting done correctly brings benefits to entities by improving corporate reputation, increasing the trust of customers and other stakeholders, improving governance and risk management, and increasing the degree of attractiveness to investors. Moreover, at the macro level such a practice supported and encouraged by large entities, clients and the market, has a decisive role in recent years, when the increasing attention given to the development and implementation of internal processes aimed at leading to progress is evident society, work standards, employee protection and the environment.

The major impact that sustainability reporting can have in the medium and long term is primarily related to improving the standard of living and health of people worldwide. External pressure, the need of stakeholders and the way in which the level of expectations of customers and the communities in which entities operate increase year by year, create value, generate profit and are an important influencing factor in generating change.

In addition to all this, digital transformation is one of the priorities of the European Union. The European Parliament is developing policies that will strengthen Europe's capabilities in new digital technologies, open up new opportunities for entities and consumers, support the green transition and help the EU achieve climate neutrality by 2050. At the same time, these policies will support the acquisition of skills, digital and professional training and will contribute to the digitization of public services, respecting fundamental rights and values.

4. The way to establish the significance threshold (materiality level) and represent the most important non-financial aspects (sustainability)

The significance threshold represents a side of relevance, where relevance, as the main attribute of financial and non-financial information, means their ability to help their users in making decisions. On the other hand, ISA 320 defines the significance threshold as the level or value above which the auditor considers that the distortion of some information has a significant impact on the financial statements.

According to the Non-Financial Reporting Directive, an entity is obliged to transmit information on environmental, social and labor issues, respect for human rights, the fight against corruption and bribery, to the extent that this information is necessary to understand the development, performance and of the entity's position and the impact of its activities.

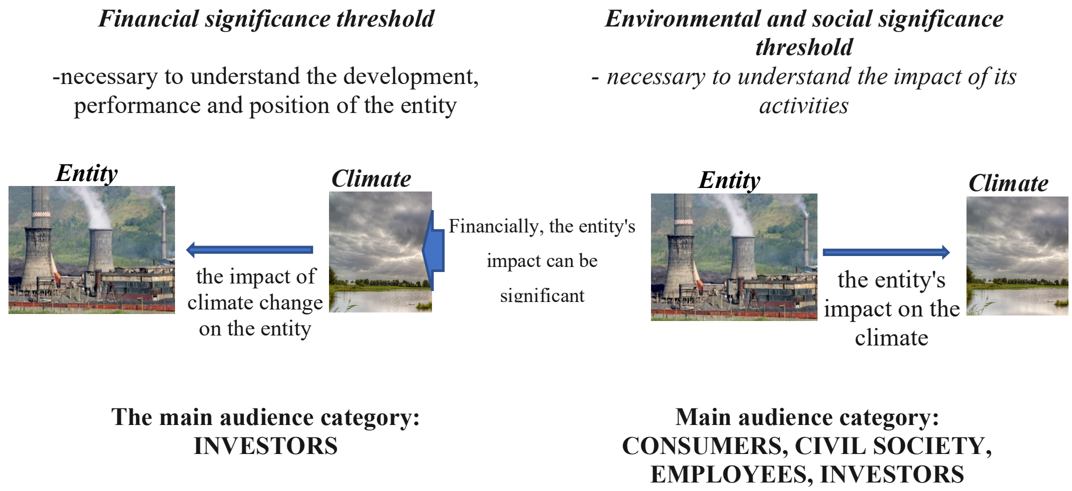
Information on climate can be considered to fall under the category of environmental issues. As stated in the Commission's 2017 non-binding Guidance on the reporting of non-financial information, the reference to the "impact of the entity's activities" introduced a new element to be considered when assessing the materiality threshold for non-financial information. In fact, the Non-Financial Reporting Directive takes a dual view of the resource materiality threshold level: the reference to the entity's "development, performance and position" shows the financial importance, in a broad sense, of the influence of the entity's value, and on the other hand the information related to of climate/ecology to be reported if this is necessary to understand the entity's progress, performance and position. This view is often of greatest interest to investors.

In other words, the reference to the "impact of the entity's activities" indicates social and environmental/ecological importance. Climate information should be reported if necessary to understand the entity's external impact. This vision is often of the greatest interest to citizens, customers, employees, business partners, society and entities, parts of civil society. However, a growing number of investors also need to be informed about their entities' climate impacts in order to better understand and measure climate impacts on investment portfolios.

So entities should consider the need to disclose the information suggested in this guidance if they decide that climate is an important consideration in either of these two perspectives. These two perspectives on risk have already intersected in some cases and will likely continue to do so in the future. As markets and public policies evolve in response to climate change, positive and/or negative climate impacts on an entity will increasingly translate into financially significant business opportunities and/or risks.

The perspective of non-financial reporting directives by developing materiality threshold analysis covers both economic, environmental and social importance, while the Financial Stability Board's Climate-related Financial Disclosure created the Working Group on Climate-related Financial Disclosures (TCFD) it only has a significant financial perspective (Figure no. 2):

Figure no. 2. TCFD's recommended dual perspective of non-financial reporting directives on materiality threshold in the context of reporting climate-related information



Source: Authors' projection, adapted from COMMUNICATIONS FROM EUROPEAN UNION INSTITUTIONS, BODIES AND AGENCIES, Official Journal of the European Union, "Guidelines on non-financial reporting: Supplement on the reporting of climate-related information" (2019/C 209/01).

Note: Directive Concerning the reporting of non-financial information (of Sustainability) *The financial significance threshold is used in this control in the broad sense of the notion, namely the impact on the value of the entity, not only in the sense of the impact on the financial resources recognized in the statements financial.

To achieve the perspectives recommended by the TCFD, the Matrix of the Threshold of Significance analysis or the Materiality Level of non-financial information was used. In order to achieve the perspectives recommended by TCFD, with reference to establishing the significance threshold and representing the most important non-financial (sustainability) aspects, the Materiality Threshold Analysis Matrix or the Level of Materiality of Non-Financial Information was used, an analysis process by which the data are interpreted based on established variables. In this stage we identify the key performance indicators specific to the activities carried out, correlated with the sustainable development objectives assumed by the entity and in accordance with the reporting standard or methodology used.

The significance threshold is expressed by two values: one of them represents the level of influence of stakeholders (all interested parties) regarding non-financial aspects, and the second one represents the entity's impact on the environment, society and the economy from the perspective of each aspect non-financial. When assessing the content of climate-related information, entities should consider a longer time horizon than is typically required for financial information. Entities are advised not to prematurely conclude that climate matters are not material simply because certain climate-related risks are perceived to be long-term. When assessing the materiality threshold for climate-related information, entities should consider their entire value chain, both upstream and downstream in the supply chain. Given the systemic and widespread impact of climate change, most entities covered by the directive can conclude that climate is a significant issue.

5. Discussion and analysis of results

Considering what was presented, an empirical study was elaborated on the threshold of significance/level of materiality, which is based on a Report made in compliance with the most important international reporting standard, the Global Reporting Initiative (GRI). The GRI standards are universal standards for ESG risk reporting (Evaluation of Social and Governance Risk) and offer one of the highest degrees of transparency on the entity's impact on the economy, environment and society.

ESG risk assessment is carried out within the own research-development-innovation department, and it is based on relevant Sustainability Analysis data, taking into account some key performance indicators-KPIs, suitable for each field of activity for which analyzes are developed and outcome assessments, where most entities are mature, with multibillion-euro valuations, investing for decades in processes and technologies to reduce emissions and with an international selection on the human component. ESG criteria are largely created for large and mature entities with well-defined strategies by internal and external subject matter experts. ESG assessment considers how well risks are managed and not whether the business model has a positive impact on the environment.

In the present case study, the ESG assessment is carried out by combining two fundamental elements: the score given based on the criteria in the analysis and the weight of the sustainability analysis.

In this context, an entity from Romania that sells fertilizers, insecticides and fungicides was chosen. Due to the constant development of environmental standards and strict consumer protection regulations worldwide, it is exposed to dynamic risks such as product bans, compliance costs or environmental fines. Atmospheric pollutants and effluents (liquid or gaseous solution leaving a facility) are the main environmental externalities resulting from the entity's fertilizer production. These emissions are subject to strict local regulations. If the entity fails to ensure compliance with local emission levels, it may experience delays in receiving operational baselines. In addition, increasing public awareness of climate change issues puts more pressure on the entity to reduce its carbon footprint and implement expensive equipment to promote and increase energy efficiency or switch to renewable energy. Failure to do so may result in reputational damage or regulatory action. The overall exposure of the entity is high and is similar to the sub-industry average. Social and Environmental (E&S) impact of products and services, carbon - own operations and emissions, effluents and waste are important issues ESG (Reporting of environmental, social and governance (ESG) results by entities is becoming very important in investor evaluation) notable (Table no. 1):

This type of report will be published with frequency and, in addition to informing the stakeholders of the entity, it will also help in attracting new customers, diversifying suppliers, but also in securing more advantageous financing, investment programs and attracting new employees and collaborators performers.

Table no. 1. Variables of the ranking of the analysis Threshold of significance in order to assess ESG risks (Assessment of social and governance risk)

Global level	*RANK (1st = lowest risk)*	*Percentage score (1st = lowest risk)*
The global universe	*11803/14735*	*80th*
Chemical products industry	*304/466*	*66th*
Agricultural chemicals sub-industry	*17/56*	*30th*

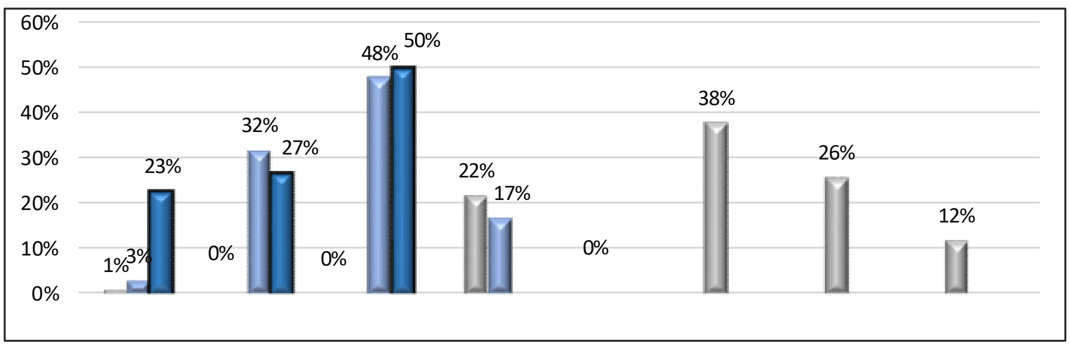
Source: authors' projection, adapted from the data from the sustainability reports of the analysed entity in conjunction with Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investments and M.F.P. Order no. 1239/October 2021, for the modification and completion of the accounting regulations applicable to economic operators, with subsequent updates and additions, which modify and complete the requirements of the M.F.P. Order. no. 1802/2014 and of the M.F.P. Order no. 2844/2016.

Risk levels

Negligible	Low	Middle	High	Very high
0-10	10-20	20-30	30-40	40+

Based on the risk assessment ranking from Table no.1, the following graphic analysis resulted (Figure no.3):

Figure no. 3. Analysis of the significance threshold by distributing the results of the ESG risk assessment, the basis of the risk assessment ranking in Table no.1



Source: processing authors, according to the sustainability reports of the entity

Note: The global universe
Chemical products industry
Agricultural chemicals sub-industry

When analysing the significance threshold by distributing the results of the ESG risk assessment, the following variables were considered: market risk, operational risk, credit risk and liquidity risk.

Calculation formulas or variables:

Market Risk = Expected Return – Risk Free Rate;
Operational risk = Impact x Probability of occurrence of the event;
Credit risk= Capital requirement (%) x Risk-balanced assets;
Risk General liquidity = Current assets / Current liabilities.

The environmental analysis led to the following results (Table no. 2.):

Table no. 2. The results of the environmental analysis

Market cap $0.2 to -$0.2 billion	***Exposure (score or risk threshold)***	***The management (score or risk threshold)***	***ESG Risk Materiality Threshold Analysis (score or risk threshold)***
Syngenta AG- relationships with suppliers of agricultural science and technology, especially seeds and pesticides	*Level of relationships with domain science providers 56.6 High*	*Business Ethics 60.9 High*	*Use of resources 26.0 Middle*
Own Carbon Operations	*67.1 High*	*66.2 High*	*27.5 Middle*
The analysed entity Exposure to ESG risks	***Business Ethics 59.3 High***	***Corporate Governance 44.2 Middle***	***Corporate Governance 35.8 High***
Consolidation of the financial position	*Level of financial position 58.0 High*	*Corporate Governance 9.1 Low*	*Business Ethics 53.2 High*
***Marrone Bio Innovations** - disclosure as a solution provider for organic crops*	*Emissions, effluents, waste 70.1 High*	*Corporate Governance 16.5 Low*	*Business Ethics 59.7High*

Source: processing authors, according to the sustainability reports of the analyzed entity, in conjunction with IAS 320, revised in June 2016: the threshold of significance in planning and conducting an audit.

The material issues considered and which led to the assessment of ESG risks are presented in Table no. 3:

Table no. 3. The material issues that led to the ESG risk assessment.

Issues	***ESG risk exposure (score category)***	***ESG Risk Management (category score)***	***ESG Risk Assessment (score category)***	***Contribution to ESG risk assessment***
Corporate Governance	*9.0 High*	*35.5 Low*	*5.8 Middle*	*16.2 %*
Own Carbon Operations	*6.7 Middle*	*18.0 Low*	*5.7 Middle*	*15.9%*
Emissions, effluents, waste	*7.0 Middle*	*37.5 Middle*	*4.6 Middle*	*13.0%*
Use of resources	*5.0 Middle*	*22.0 Low*	*4.6 Middle*	*11.5%*
Human capital	*5.0 Middle*	*25.1 Middle*	*4.1 Middle*	*10.6%*
Community relations	*3.6 Low*	*0.0 Low*	*3.8 Low*	*10.1%*
Business Ethics	*6.0 Middle*	*59.4 High*	*3.6 Low*	*7.3%*
E&S impact of products and services	*8.0 High*	*90.5 High*	*2.6 Low*	*6.2%*
Product governance	*3.0 Low*	*47.5 Middle*	*2.2 Low*	*4.8%*
Health and safety at Work	*6.0 Middle*	*77.5 Low*	*1.7 Negligible*	*4.4%*
Total	***59.3 High***	***44.2 Middle***	***35.8 High***	***100%***

Source: processing authors, according to the sustainability reports of the analyzed entity

Discussions and interpretation of the results from table no. 3:

1. Corporate governance: score 5.8 - Accessible management;

2. Own carbon operations: score 5.7 - Requires improvements by reporting GHG emissions (greenhouse gases), accompanied by the implementation of GHG management, a policy and a transition to renewable energy sources;

3. Emissions, effluents and waste: score 4.6 - it is recommended to improve management through investments in water treatment and reuse, more detailed monitoring and reporting, especially for non-GHG emissions and waste management;

4. Use of resources: score 4.6 - risk can be improved through more detailed monitoring and reporting;

5. Human capital: score 4.1- recommends that attention be paid to research and attracting highly qualified human resources to have products that are easily adaptable to the climate;

6. Community relations: score 3.8 - management is satisfactory, but can be improved through a clearer human rights policy;

7. Business ethics: score 3.6 - management is strong. There were no incidents of corruption or influence peddling;

8. E&S impact of products and services: score 2.6 - management is strong because the products are environmentally friendly. It is recommended to improve performance through a green/ecological procurement policy;

9. Product governance: score 2.2 - outstanding product safety performance. Improvements can be made by adopting a stronger marketing policy and more robust quality control;

10. Health and safety at work: score 1.7 - management is strong, there have been no accidents at work or other such events, but improvements can be considered through occupational health and safety policies for contractors.

Considering the presented results, the following conclusions were drawn:

*The entity's global exposure is high and similar to the sub-industry average. The E&S impact of Products and services, carbon - own operations and emissions, effluents and waste are important ESG issues (Reporting of environmental, social and governance (ESG) results by sub-industry to entities is becoming very important in investor evaluation) notable. Exposure 59.3 high risk (risk significance threshold +55), indicates the entity's sensitivity or vulnerability to ESG risks. We consider this score to be an acceptable one that can be improved in the future.

Beta = covariance of market return with stock return/variance of market return

Beta = 0.4/0.416 = 0.96

Beta < 1 Low risk; **Beta** > 1 high risk.

The exposure score in this case was based on sub-industry and entity-specific factors such as its business model.

**ESG risk management of 44.2 middle (ESG risk management significance threshold between 50-25), reveals that ESG disclosure for better consolidation of the entity's financial position is lacking, as it has not published relevant reports or data in accordance with international standards such as those of the GRI in recent years. But the entity's ESG issues are overseen by its board, which suggests that ESG issues are integrated into the entity's core business strategy or governance. The entity's overall management of material ESG issues is average, and can be influenced and better managed through appropriate policies, programs and programs and firm management initiatives.

Management risk assessment refers to how well the entity has been governed/managed with respect to relevant ESG issues. Our management score assessed the robustness of the ESG programs, practices and policies used by the entity.

***Analysis and evaluation of the significance threshold regarding ESG risk, ESG risk of 35.8 high (significance threshold of ESG risk between 30-40), which was not managed by the entity includes two types of risk: unmanaged risk, such as and risks that could be managed by the entity through appropriate policies and programs and firm management initiatives, but are not yet sufficiently managed.

6. Conclusions

Considering the increased attention paid in recent years to non-financial reporting on aspects related to sustainability, our scientific approach aimed at two objectives:

1). the evolving analysis of financial and non-financial reporting systems in order to identify a reporting format, types of data and information that meet the requirements, considering the specifics of the entity, the specifics of the sector in which it operates, as well as the information needs of stakeholders;

2). the development of an empirical case study regarding the establishment of the threshold of significance and representation of the most important non-financial aspects by analysing some well-established variables (the level of influence of the stakeholders regarding the non-financial aspects and the entity's impact on the environment, society and the economy from the perspective of each non-financial aspect).

The quantitative analysis concerned aspects related to the structure of the reports, the analysis of information at the level of the Sustainable Development Goals, the non-financial (sustainability), national, European or international reporting frameworks in which economic entities can choose to provide information, the perspectives recommended by the Group task force for climate-related financial disclosures - TCFD, a non-financial reporting directives on the materiality threshold in the context of reporting climate-related information.

For the elaboration of this scientific approach, the qualitative analysis was based on the information of the financial reports, the sustainability reports of the analyzed entity and the databases available on the website of the Bucharest Stock Exchange. Both the information from the financial and non-financial reports led us to a clear detection of the significance threshold of the ESG risk (Evaluation of Social and Governance risk), in terms of the business model, which is structured on three main pillars: research, production and sale of organic inputs.

As an essential conclusion of this scientific approach, we can state that: the positive impact on the industry, to a large extent, is the elimination of GHG greenhouse gases from the production of agricultural inputs, and the ranking is a good one, which can be improved by monitoring and data collection, profitable investments and sound policies, as described above, in presenting the results of the case study, while respecting international standards.

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