Financial Reporting vs. Non-financial Reporting: Differences and Recommendations

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Abstract: International investors are now increasingly demanding the presentation of financial and non-financial information in order to understand how much the entity's performance can be affected by the way it handles environmental issues, human resources, anti-corruption, the relationship with the community as well as to understand the possible risks associated with the activity of an entity, risks that could be faced, precisely by detailing the non-financial information to be interpreted together with the financial one. It is increasingly imperative to draw up a framework report on non-financial reporting that links financial and non-financial performance, with the possibility of long-term prioritization of business plans with benefits to the entity as well as to its outer sphere.

Keywords: financial reporting; non - financial reporting; sustainable development; sustainability; economic entity

JEL Classification: M41

1. Introduction

The need of drawing up a non-financial framework report for economic entities in Romania

Recently, one of the main roles in decision-making is represented by corporate governance, a top-notch approach both in the literature and in practice, both in our country and at EU level. There is particularly appreciated the importance of paying close attention to corporate governance and exceptionally emphasizing the role of non-financial reporting as well as the implementation of EU Standards on non-financial reporting and corporate governance code.

The non-financial reporting, also known as **sustainability reporting**, is the way in which an economic entity, or any other entity, publishes information regarding the

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environmental, social and economic impacts and performance of its current activities. It is about information in the following areas, such as:

Environment protection	*the impact of operations on the environment, health and safety at work, the use of renewable and traditional energy resources, greenhouse gas emissions, air and water pollution;
Social and employee issues	*relations with the suppliers and distributors, measures taken to ensure gender equality and respect for employees' rights, ensuring optimal working conditions, payment of social security contributions, social dialogue, respect for workers' rights to be informed and consulted, respect for trade union rights, health insurance and work safety, communication with local communities and actions for the development of these communities;
Respect of human rights	
Anti-corruption measures and bribery prevention	
Diversity at the level of management structures	

A non-financial and sustainability report will also include information on environmental, social and personnel issues, respect for human rights, the fight against corruption and bribery, including:

*a brief description of the entity's business model;
*a description of the policies adopted by the entity as related to these matters including the applied due diligence proceedings;
*the outcome of those respective policies;
*principalele the main risks related to these concerns arising from the entity's operations, including, where relevant and proportionate, the business relationships, products or services that could have a negative impact on those areas and the way of managing the entity's risks;
*non-financial key performance indicators relevant to the specific entity's activity.

2. Literature Review

In 2014, the European Parliament and the European Council adopted the Directive 2014/95 / EU, by having required public interest entities with more than 500 employees to submit a non-financial statement or a non-financial report in addition to the directors' report that independently included information about the economic, social and environmental impact of the entity.

The Directive was transposed into Romanian legislation by the Order of the Minister of Public Finance no. 1938/2016, which came into force on January 1, 2017 and the Order of the Minister of Public Finance no. 345/2018, by Law no. 111/2016 for the approval of the GEO no. 109/2011, but also through a series of norms adopted by the National Bank of Romania, respectively by the Financial Supervisory Authority.

On this regard, starting from 2018, the Directive 2014/95 / EU required the entities in Romania, which fell under the scope of public interest entities to present information on the effects of their activity on the environment, social issues and on the staff employed, as well as the way of complying with: human rights, measures to eliminate corruption and bribery and information on variety at the level of the organized task force.

Therefore, another model of financial reporting started from the business environment in our country, namely integrated financial reporting. Just being perceived the information document for investors, as well as for other parties interested in the success of the entity, the consolidated financial reporting, now also includes elements of social order and influence on the environment an entity operates in.

3. Research Methodology

Starting from existing theories, concepts, models and methods to put them into practice, this study belongs to the research category based on deductive approaches but then moves on to inductive approaches due to the theoretical and conceptual transposition of the identified practical aspects. The research methodology used is based on a scientific approach that combines the two essential forms of any research - theoretical and empirical and goes on the rationalism-empiricism axis, in the middle way, by choosing a hypothetical-deductive reasoning, and in some cases, the logically - inductive ones. Theoretical research methods were used, such as: non-participatory observation, text analysis, classification, ordering and systematization of information; data interpretation etc. The information sources used to carry out this research include: national and international specialized books; specialized articles published in renowned journals with national and international recognition, legislative acts; regulations of national and international professional bodies; studies and research conducted by various professional entities.

3.1. Perceptions on the Means of Improving the Internal Managerial Control System

The non-financial and sustainability reporting process involves a number of advantages (as we can see on ***Figure 1)*** that can be turned into opportunities contributing to the integration of sustainable development concepts.

Monitoring and assessment of sustainability performance as well the identification of areas for improvement.
A better understanding of the impact, risks and opportunities that will contribute to process optimization, cost reduction, productivity improvement and the structuring of management strategy and policy.
Highlighting the connection between financial and non-financial performance so that the business plans can be prioritized.
Internal comparison of performance as well as between entities and sectors of activity.
Employee motivation generated by the good performance and good reputation of the entity.
The avoidance of the involvement in public scandals due to environmental, social or governance failures.
The brand trust and reputation improvement remarcable especially after the first reports, but with a strong dependency on the balance and honesty in the art of reporting.
Increasing competitiveness and attracting new capital sources as the potential investors have access to more relevant information than legally required.
Easy access to information on all aspects of the environment, staff, human rights or anti-corruption measures for both members of the organization and those outside (customers, suppliers, investors, local community, civil society etc.).
Increasing the company's visibility in the community and on the unfolded social responsibility initiatives

Starting from the idea of the successful governance requirements, respectively of the current conditions' recognition at the level of an entity, the role played by the non-financial reporting drawn up by the economic entities subject to corporate governance becomes even more important.

4. Financial Accounting vs. Non-Financial Accounting and the Link between Financial Reporting and Non-Financial Reporting

The common principles underlying any efficient economy are: transparency, accuracy and integrity of the information that will be made public and broadcast to all stakeholders.

Therefore, we are approaching another accounting: *the non-financial accounting*, as an integral part of management accounting, a new science of the future that combines economics with engineering and social and which will have as main objective the registration and quantification of all operations from an entity, whether related to the environment, people or economic prosperity.

If in financial accounting the profit is calculated as the difference between income and expenses and the resulting profit is distributed exclusively to shareholders, in non-financial accounting the profit, or rather prosperity, will be equal to the difference between positive and negative impact. The final result, i.e. social and environmental benefits, will be distributed to all stakeholders like: citizens, authorities, employees, shareholders.

The financial accounts are very limited, representing “a set of entities, activities and operations for the entire entity, including subsidiaries”. The objective of **management accounts** is much narrower, being focused on specific activities, payment accounts, sections or departments.

One of the responsibilities that managers have, is to accurately prepare and submit financial reports and, more recently, non-financial reports. If financial reporting is a well-known concept, non-financial reporting is a relatively new concept implemented in Romanian practice and legislation.

The non-financial reporting obligation has its source in European directives, just like all regulations that bring essential changes in the way of markets’ and entities’ thinking and functioning. This non-financial reporting obligation has already come in force and started to be applicable, with the end-of-year 2017 to listed entities, as well as to entities with majority state capital and other public interest entities.

4.1. Different Procedures

The required information for the implementation of the non-financial report includes, as the title announces, all non-financial aspects that are relevant to each entity such as: environmental issues (energy consumption, water, emissions, waste, biodiversity, resource management, environment), the impact that the policies, the actions of the entities have on the social aspects related to the community.

There are also reciprocal effects and links between non-financial and financial indicators such as: a transparent policy and a product and marketing ethic (subject of non-financial indicators), which can lead to an increase in turnover (financial indicator) as the absence of the entity's actions on the environment, taking over the responsibility for exploitation and recycling of waste introduced into the economic circuit (non-financial indicator) have a significant effect on the cost of services (financial indicator). Between the two reporting models, there are a number of procedural differences that are summarized in **Table 1** (Fătu, 2018).

Beyond the procedural components, as it results from the analysis below, some conclusions can be drawn regarding reporting and governance, not only in terms of personal responsibility of managers but also in terms of evaluating the governing act. Hence, it is found that, in the case of financial reporting, the evaluation of the governing act is done only by shareholders, in the case of non-financial reporting, the evaluation is made by other stakeholders such as employees, customers, community etc. However, the link between the two reports is that they complement each other with extremely important information that leads to long-term performance, giving the entity a clear view of the future.

Table 1. Procedure Differences

Reporting	Responsable	Actions	Deliverable	Who is it for?	Acțiune
Financial reporting	Managers	propose	BVC Financial statements Financial indicators	Shareholder (AGA)	- approves/rejects -approves/rejects - approves/rejects -approves rejects
			Profit distribution/losses coverage, Download of the managers' administration		
	The financial/certifies Statutory auditor		The independent auditor's report		
Non-financial reporting	assert Managers	report	Non-financial statement Non-financial report Non-financial indicators (including governance assessment as well)	Shareholder (AGA) Employees Customers	- invests/disinvest - retention/lay-offs -sales

	The financial/ certifies Statutory auditor	If the non-financial statement or proper report has been provided and this stipulates the information in the independent auditor's report.	Suppliers - business ongoing Community - business ongoing

Own source adapted from "Revista de studii financiare", Vol. III, Nr. 4, Mai 2018.

Whether for financial reporting , the evaluation of the governing act is done through the obtained results and, in addition, shareholders may hold managers accountable for how they "monitored" their provided resources and in the case of non-financial reporting, the evaluation of the act is made by all stakeholders relying on the principles which analyze the flows and methods used by management in the decision-making process to ensure that decisions are made through a series of analytical processes aimed at good results that can be in the control of decision makers" (Fătu, 2018).From this perspective, the non-financial reporting can be used by managers, as a practical marketing tool but also as a validation system, continuous updating of internal control methods.

The non-financial reporting is the framework through which a business can understand both its exposure to the risks of these developments and its ability to benefit from new business opportunities. At the same time this reporting is the process by which an entity can gather and analyze the data to create long-term value and resilience to environmental and social changes. This is essential to convince investors that the business is viable beyond the next period or next year.

The way in which all the above elements are evaluated, makes the difference between a government that can bring a lot of profit or loss to the entity. Hence the concept of „prudent and diligent administrator (manager)" introduced by the Companies Law in defining the personal liability of administrators.

The law also states that the director is considered to act as a prudent and diligent director if "at the time of making a decision, he is reasonably entitled to consider that he is acting in the interest of the company and on the basis of adequate information"[1].

[1] Legea societăților nr. 31/1990 cu modificările și completările ulterioare.

4.2. Corporate Governance Policies, Practices and Responsibilities

Corporate governance is a complex of processes, practices, policies, regulatory framework, with an impact on the management, administration and control of an entity.

The most significant benefits of corporate governance encompass the cut of risks that business can bear, the evolution of performance, the receptivity to communicate with other markets, maximizing transparency and social responsibility. The lack of rules can send an entity to a total disorganization, a situation in which any investment can be a game of chance and the predictability can no longer be discussed but disappears.

Currently, the corporate governance is still a strategic issue. The corporate governance activities, where the degree of involvement is one that should reflect the present effectiveness as well as the future prospects, include involvement in the remuneration process of the directors’ board and executive management, the provision of relevant courses for the board of directors and for the analysis and assessment committee, performing analyzes of the data provided by the board of directors, as well as facilitating the internal assessment of the board of directors and the analysis and evaluation committee.

At the same time, the optimization of the risk assessment process indicates that the results of these assessment are frequently made available to the Management Board. However, the risk assessment process does not always provide relevant information on the strategic risks that the board needs. The present question is whether the available levers for internal control currenty help or fail to do so in order to assess the main risks of the business, and the answer lies somewhere in between.

Following the documentation based on practical scientific studies and analyzes, there was pointed out the intention of the assessment committees to assist the board of directors and management in this emerging area where there is still a lack of clarity regarding the desired objectives and results. Thus, optimizing the risk assessment process involves concentrating and refining the identification and assessment of strategic and emerging risks.

This involves the changing of the traditional risk assessment process (risk assessment based on the universe of urgent assessment to make commitments regarding the identified risks’ correction, in order to meet the objectives of those processes, locations or entities) and the concentration on a “top-down” approach consisting of identifying the most significant risks at the organizational level in accordance with the entity's strategy to meet the objectives at the highest level.

In other words, the integration of risk and compliance activities shows that the rationalization of corporate governance as well as the risk and compliance activities are necessary to reach a strategic level, and the involvement of coordination, assessment and internal control functions in the risk management process must focus on the following issues: defining the risk management and compliance process; defining risks and establishing a common organizational risk framework; development of a common risk assessment methodology, integration of assessment plans with compliance commitments.

Most of the planned or even implemented coordination, evaluation and internal control functions involve the following of the steps described above, including coordination and integration of the internal evaluation and control activities as well as risk and compliance ones. **(Figure 2):**

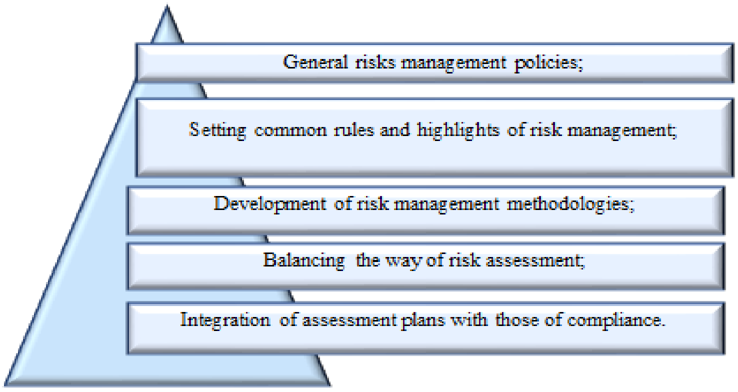

Figure 1. Necessary Steps to Ccordinate the Conformity Practies and Policies and to Integrate the Risk and Conformity Functions
Own source

The integrity of internal and risk assessment activities, external assessments and other compliance activities are the concern functions for the implementation of structured processes. Therefore, the continuing need to work for coordination improvement and integration with external assessment, risk management processes, information systems security and compliance and legal processes are of great interest for sustainable development.

The three levels presented in **figure 3.** represent the value-added activities of the internal assessment function, ordered by levels of sustainable development, and its bottom describes the basic activities of the assessment function.

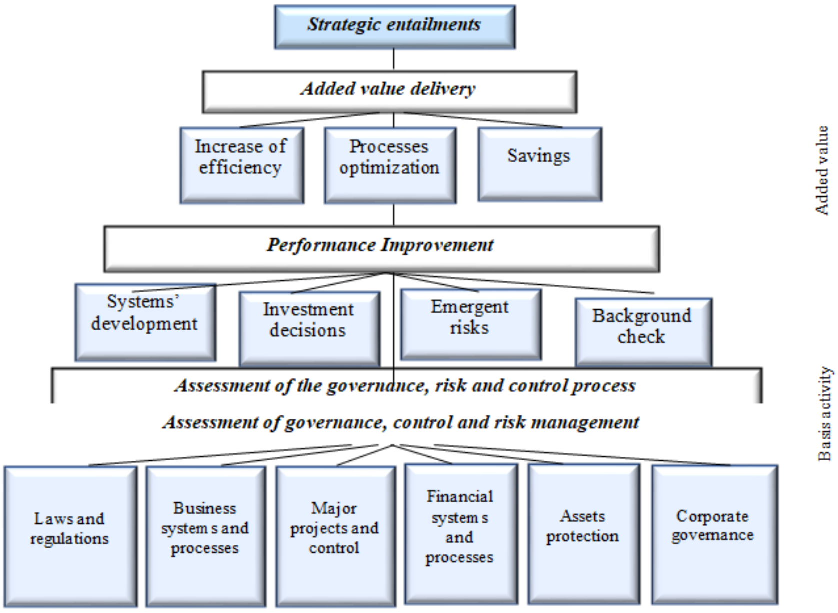

Figure 3. Principles and Policies of Corporate Governance for the Creation of Added Value, Ordered by Development Levels.

Own source

In this case, the Management Board will put in place the best strategies to ensure a high degree of probity and fairness regarding substantial business compliance procedures with stakeholders. For this purpose, it will use at least the following criteria:

*retaining the power for the most important agreements approval;
*requesting a preliminary opinion regarding the most significant agreements from the internal control structures;
*entrusting the negotiation of these agreements to one or more independent directors (or unrelated directors);
*appealing to independent experts (possibly selected by independent managers)

In most of countries, the board of directors bears the responsibility for ensuring a careful and effective control environment, which allows risk assessment and management and imposes certain responsibilities for it (see **Figure 4**)**:**

Figure 4. Responsibilities of Directors' Board from taking into account the Corporate Governance Codes

Own source based on European Corporate Governance Institute, http:// www.ecgi.org/codes/all_codes.php.

The integrated conceptual framework proposes a model of efficient risk management by applying internal control procedures within an entity, regardless of its size and complexity.

This model highlights the critical differences in the assignment of roles and responsibilities between the board of directors and executive management. In particular, the role of the model is to clearly define the differences and relationships between the activities of ensuring the achievement of the entity's strategic objectives and its supervisory activities.

The procedures applied by the board of directors will cause precisely the specific cases (or will help to establish the criteria for their recognition), needing approval after the rumination of those who are part in the internal control groups and / or support from external experts. One of the components that is not sufficiently well evaluated and improved is the social responsibility of corporate entities. We need to adjust to the general idea that correctly reflects the reality of social responsibility and to be aware that this is just the beginning of our goal.

In this context, there is demanded a guidelines development for the understanding of the principles and strategic policies of corporate governance, principles that already exist and are used, but still the used terms do not have a correct transcription into Romanian. Here we can talk, more precisely, about accountability and stakeholders (responsibility of entities and stakeholders). The better perceived these terms are, the more the concept of corporate governance will be embraced by the business environment and will enhance as based on benefits for entities and stakeholders.

The corporate governance code of entities needs to be linked to accounting and internal rules, but it should not be an end in itself. Only the added value that can be brought to the entity and those that depend on it can be the necessary motivation for its adoption. Corporate governance is traditionally known as the structure through which entities are coordinated and controlled[1] and as a type of relationship between the management of any entity, the board of directors, its shareholders and other stakeholders (OCDE, 2004, p. 11).

The corporate governance structure for listed entities in the EU is an association between legislation and the oft law, which includes recommendations and a set of corporate governance rules. Although these corporate governance rules are not implemented at national level, Directive 2006/46/ EC encourages their implementation by requiring listed entities to refer to the rules in the code in their corporate governance statement and presents information that refers to the way in which it was put into practice based on the "apply or explain" principle[2].

Thus, two preliminary issues deserve to be brought to the attention of the entities and parties involved. Firstly, the European implementing rules on corporate governance are intended for "listed" entities (more specifically, entities that issue shares accepted for trading on a regulated market). Usually, they do not differentiate between entities according to size[3] or shape.

However, some Member States have their own corporate governance procedures, adapted to each type of listed small and medium-sized entity[4], such as the majority shareholder may also be the main manager (director). Those codes contain recommendations related to the shape, size and structure of the entity and, as a result, their implementation is user-friendly, which should not be difficult to implement for small entities. In other Member States, these procedures developed

[1] "Report of the Committee on the Financial Aspects of Corporate Governance" (Raportul Cadbury), 1992, p. 15, (http://www.ecgi.org/codes/documents/cadbury.pdf).

[2] This approach assumes that when an enterprise decides to bypss a corporate governance code it must mention the bypassed parts of this code explaining the reasons of this decision.

[3] However there are some exceptions, for example the article 41, intendednline (1), second paragraph of the Directive 2006/43/CE of the EU Parliament and Council, May, 17th, 2006, regarding the legal audit of the annual and consolidated accounts, for the amendments to the Directives 78/660/CEE and 83/349/CEE of the Council and of the Directive 84/253/CEE annulement in the Council (JO L 157, 9.6.2006, p. 87) which authorizes the member states to allow the quoted SMEs to work without a separate audit commission..

[4] See, for example, Code de gouvernement d'entreprise pour les valeurs moyennes et petites, decembrie 2009, Middlenext, disponibil la adresa: http://www.middlenext.com/.

for all listed entities comprise a particular type of procedure accepted by small entities[1].

Therefore, we wonder whether the EU needs to accept a distinct approach and how the possibilities and actual problems of implementing these principles of corporate governance by entities of all types and sizes[2] can be exceptionally taken into account.

Secondly, an adequate corporate governance to these requirements may be exceptional, both for shareholders of unlisted entities and for all related stakeholders. Although many of these corporate governance's aspects are already put into practice, through decisions taken in accordance with the legislation underlying the organization of entities by business, with reference to private entities, many of these areas are not yet covered.

In these circumstances, it is necessary for entities to be supported in the development of guidelines by persons specialized in the field, on corporate governance, as well as for unlisted entities: good governance with a high degree of efficiency is extremely beneficial for unlisted entities as well, considering in particular the economic importance of many very large but unlisted entities.

In other words, the conditions of a mandatory requirement for an administrative task that is difficult to bear on listed entities would make their listing increasingly unpleasant. However, the principles developed and considered for listed entities cannot simply be passed on to unlisted entities, as they may face various challenges that are difficult to manage. Some voluntary codes are already implemented and are based on a number of initiatives taken by professional bodies at European[3] or National level[4]. So in this situation, we wonder if there is a need for EU intervention in this area regarding the corporate governance of unlisted entities.

[1]See, for example, Codul de guvernanță corporativă (Corporate Governance Code) al Regatului Unit, disponibil la adresa:http://www.frc.org.uk/corporate/ukcgcode.cfm.

[2] The logic to cut the administrative liability of the SMEs is also to be found in the current revision of the accounting directives (Council Directives 78/660/CEE and 83/349/CEE), though there will be mainly targeted to the unquoted enterprises and in the Green Book regarding the audit policy published in 2010, COM (2010) 561 (http://ec.europa.eu/internal_market/consultations/docs/2010/audit/green_paper_audit_en.pdf).

[3]Corporate Governance Guidance and Principles for Unlisted Companies in Europe, (EcoDa), http://www.ecoda.org/docs/ECODA_WEB.pdf.

[4]See, for example, in Belgium, Buysse Code — Corporate governance recommendations for non-listed enterprises (http://www.codebuysse.be/downloads/CodeBuysse_EN.pdf); in Finland, Improving corporate governance of unlisted companies) (http://www.keskuskauppakamari.fi/content/download/19529/421972); in UK, Corporate Governance Guidance and Principles for Unlisted Companies in the UK, Institute of Directors (http://www.iod.com/MainWebsite/Resources/Document/corp_gov_guidance_and_principles_for_unlisted_companies_in_the_uk_final_1011.pdf).

Therefore, in order to promote sustainable development worldwide, the EU will continue to cooperate with external partners, using all available tools in its external policies and, in particular, supporting the efforts of developing countries.The goals of sustainable development are planned to achieve a better and more viable future for all.They dwell upon the global challenges we face, including those related to poverty, inequality, climate, environmental degradation, prosperity, peace and justice. Establishing connections and goals so as not to leave anyone behind, it is important to achieve every current goal and goal until 2030[1]. The identified major trends, which had to indicate these innovative strategic principles and policies (see on **Table 2)** referring to non-financial reporting at EU level were: climate change, resource constraints and global competition (Reid & Miedzinski, 2008, p. 196).

In the international practice, most solutions for developing corporate governance policies and principles have been transposed into codes of good practice and they appear as regulations or guidelines, regardless of their form and country and are intended to be used as models of administrative organization and management of private entities and public service providers. More than 35 such codes have been implemented at EU level, i.e. almost every country has at least one corporate governance code:

Table 2. Innovative Non-Financial Reporting Policies (Sustainability)

Category	Measures	Field
Market-oriented policies	Fiscal measures (issues taxes, tax exemptions, investments credit, VAT), Scheme of issues certificates	Fiscal policies
Public acquisitions	Ecological public acquisitions	Horizontal policies, particularly in public administration, urban works and constructions, transport, dwellings and protection.
Legislative framework	Regulation of energy system, Technological norms and standards, Energy efficiency, Notifications, Authorizations and Suspensions, Land use, Environmental management system, Economic labeling and tools for voluntary standardization enhancement.	Environmental policy; Industrial policy; Energy policy; Economic and trade policy; Local development policy.

[1] Communication on the next steps for a sustainable European Future,June, 13th 2017.

Innovation subsidies	Loan and credit financial schemes, Direct subsidies, Mutual investment funds, Programs for business hubs, CDI targeting and technological programs, Business consultancy, Ecological clusters policies.	Economic policies; Energy policies; Innovation policies; Entrepreneurship policies; Research policies; Regional policies.
Management and evidence ability	Professional training in enterprises for ecological efficiency, Amendments of the educational programs and curricula	Training and educational policies.
Prospective and strategic planning	Ecological foresight, Local strategic planning	Horizontal policies.

Source adapted from Reid, A. & Miedzinski, M., 2008.

Many reporting entities show that there is no direct correlation between reporting and integrity. However, the connection is rather indirect: reporting induces a pressure not to make mistakes. Conflict of interest policies are quite widespread in Romanian entities. They require rigorous procedures for reporting and preventing such situations, and some entities even complain about the bureaucratic influence induced by these procedures. The assumption from which these policies start is that the responsibility for anticipating and declaring a conflict of interest rests with the employer, hence the need for training and form completion.

6. Conclusions

The information used to draw up an annual report, as well as the financial and non-financial performance indicators used to measure the performance of entities, play a key role in making sound decisions and achieving the success of all stakeholders and the goals set periodically by managers. and last but not least, of long-term sustainability.

There is an increasing need for an annual report meaning a balanced set of key performance indicators that include both financial and non-financial indicators, relevant to the financial dimension (extending the focus exclusively to the profit and loss account with areas such as the liquidity situation, capital efficiency, financing, risk position, etc.) but also for the non-financial one (value generating factors for financial performance).

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