Sustainability and technology: two challenges for financial reporting

Sabrina Pucci, Marco Venuti

Purpose – The purpose of this work is to highlight how the degree of stakeholder engagement, regarding the sustanaibility value and the technological issue, is related to different company sizes and national environment, and how this information has improved as a result of the application of the recent European regulation focused on non-financial information.

Design/methodology/approach – The analysis is based on a multi-stakeholder approach applied in a two-step analysis based on public information of Italian and European listed companies. The first step is based on quantitative analysis aimed at investigating the contents of the disclosure provided by a sample of listed Companies, belonging to three European Nations. The second step consists in the analysis of the 2017 non-financial statement declarations of the Italian listed companies divided by sectors compared with the analysis of the companies 2016 financial statements to verify the impact of the new law on non-financial information provided.

Findings – Referring to the first step of analysis, the research highligths the different degrees of stakeholders' engagement regarding the companies of different Nations and different sizes. Refering to the second step of analysis, the research highlights a meaningful impact of the new regulation on non-financial information provided, eventhough we found the way of comunicating non-financial information is heterogeneous and sometimes incomplete.

Originality/Value – This work contributes to the research on the sustainability value and the technology issue in different ways. Firstly, this paper carries out a new comparative analysis focused on different jurisdictions and environmental contexts taking also in account the company sizes. Secondly, this is one of the first research that takes into consideration the effects of the recent regulation on stakeholders' engagement. Thirdly, the analysis carried out contributes to validating a tentative conclusion regarding the possibility of developping a regression model that could permit to measure the link between the increase in sustainability and technology information in financial or non-financial statements and the market value.

Keywords – Sustainability, Non-Financial Statement Declaration, Financial Statements, IT Developments, Accounting Standards edium-sized enterprises, Integrated reporting, Integrated report, Case-study ntegrated Reporting; Intellectual Capital; Stakeholder Engagement; Performative Approach; Case Studies Method.

Paper type – Extended Abstract.

1. *Introduction*

The European Directive 2014/95/EU and the following European Commission Communication 2017/C215/01 was a relevant step towards the recognition of the importance of non-financial information for stakeholders. Non-financial information is expected to make companies more transparent and also more resilient and long term value oriented. That kind of information, combined with a specific disclosure on technology assets and risks, ought to help the different stakeholders to measure, monitor and manage the company's performance and its sustainability over time.

The European Directive followed a worldwide trend that made integrated reporting one of its central points. Before the application of this Directive, there were different rules and experiences: from France with the Grenelle prescriptions (where the definition of some social indicators such as climate change, conservation of biodiversity, better public information, prevention of risks, etc.) to Germany's experience of sustainability reports, from the UK London Stock Exchange pronouncements to Italy with article 2428 of the Civil Code which required the description of main risks and uncertainty that affect companies and the presentation of expenses for research and development. All these different legal requirements seek to obtain the same result: disclosure of long term substainability of businesses.

2. *The approach adopted*

In previous years, the weight of non-financial information was normally not so relevant in financial statements (a first legislative signal at European level was introduced only by Directive 2003/51/EC) and a lot of companies presented a substainability report as a separate document from their financial statements. The integrated report was prepared by the management only in limited cases, depending also on the country in which the company had its main market. There were multiple frameworks, standards, goals and codes in the non-financial reporting analysis. The closest to general acceptance is the Global Reporting Initiative (GRI), whose standards are used by companies in over 90 countries[1] but is something different from a financial reporting standard.

So the request for disclosure of long term sustainability of businesses opens an interesting debate on the content of financial statements and on the relevance of this information for investors. As a recent EU analysis[2] has shown, the main sustainability factors considered by investors are climate and governance factors (75%) and environment and social factors are a bit less relevant. In every case, most investors (75%) would like to have information about sustainability factors (and pension funds are the most interested).

In this debate, another variable was added: how to reach financial disclosure of technological assets and risks, which are now a fundamental value from a long term point of view. To understand this, it is sufficient to consider cyber risk or the impact of technology on sales channels and on product design.

Looking at the sustainability value and at the technological issue, our analysis tries to verify what kind of information may be found in the last few years in financial statements of listed companies (separating between the information included in financial statements or in the social reports) regarding these topics and if the non-financial statements[3], issued for the first time in 2017, are fundamental to improve the level of understanding on these topics from an investor's point of view.

The analysis is based on a multi-stakeholder approach applied in a two-step analysis based on public information of Italian and European listed companies.

The first step is the study of the contents of the disclosure provided by a sample of 75 listed Companies, of which 26 Italians listed on the Italian Stock Exchange, 24 Anglo-Saxons listed on the London Stock Exchange and 25 German listed on the DAX, belonging to the energy and industrial sectors. For the purpose of the research, the companies are also divided into sub-samples based on company size (large, medium and small companies). The study considers non-financial information included in consolidated financial statements or in specific non-financial reports for the periods 2014-2016.

This research analyses to what extent the companies of the sample

[1] IASB, 2017.
[2] UE analysis 24.05.18.
[3] Legislative Decree 30 December 2016, n. 254 and Consob deliberation n. 20267, January 2018.

guarantee users information appropriate to the principles envisaged by the IIRC (International Integrated Reporting Council) or the GRI regarding stakeholders' engagement and environmental disclosure.This research also investigates the different degree of disclosure compliance on the basis of company size.

The second step consists in the analysis of the 2017 non-financial statement declarations of the listed Italian companies divided by sectors compared with the analysis of the companies 2016 financial statements to verify the impact of the new law on disclosure.

The first step analysis is almost completed, the second is in progress.

3. *Some initial considerations*

Referring to the first step analysis, the study highlights that the percentage of stakeholders' engagement decreases, passing from the category of large companies to that of small companies. This decrease is more pronounced in Italian companies due to the limited propensity of small-sized companies to satisfy a stakeholders' engagement.

In addition, the research finds that:

a) large Italian listed companies are characterized by a high degree of stakeholder engagement, as a result of a voluntary adoption of reporting criteria set forth by GRI and IIRC;
b) large Anglo-Saxon listed companies provide a non-financial level of disclosure which, in a homogeneous manner, offers a more pragmatic view of the business carried out, as it seeks to make a synthesis between the results obtained by the company and the associated risks. The dissemination of this kind information is carried out in compliance with the reporting criteria reported in the "UK Corporate Governance Code";
c) German listed companies have been able to reconcile the needs of stakeholders to acquire non-financial information - which meets only certain categories of stakeholders needs (shareholders and lenders) - with the articulated work of preparing financial statements from heterogeneous contents. However, clear standardization of the financial statements published in the three years taken into consideration is observed with respect to the financial statements of Italian companies.

Referring to the second step analysis, the following aspects should be mentioned. There are a lot of different ways adopted by companies to respond to Italian legal requirements. First of all, there is a big difference between those companies with an integrated report and those without.

In the first case, there are two main behaviours: some companies, in order to avoid a double system of similar information in the non-financial statement, use systematic recall of the integrated report paragraphs that analyse the non-financial quantitative data (KPI) required by the law. Others have prepared a completely new report that contains all the information required by the law even if part of this information is already present in other public documents.

In the hypothesis of companies without an integrated report, it is possible to find both detailed reporting with indexes indication and a very short report with only the main KPIs.

Some differences exist also in the non-financial statements of financial and non-financial companies. In some cases, the links with financial results or the links with social reports are clearly defined, in some cases the reconciliation is not so clear.

Referring to technology, it is not easy to find detailed information on costs and value creation due to this asset but it is also difficult to have a precise perspective of the risks that affect companies regarding technology.

Considering these first results, it is possible to adopt a tentative conclusion with the idea of developing a regression model that could permit measurement of the link between the increase in sustainability and technology information in financial or non-financial statements and the market value that validated this conclusion. Even if the consciousness of the importance of long-term value creation has significantly increased, the presentation in the annual accounts of some drivers that permit this long-term value creation is not fully integrated with the financial values and is integrated in a different way from company to company.

References

Ahmadi, A. & Bouri, A. (2017). The relationship between financial attributes, environmental performance and environmental disclosure: Empirical investigation on French firms listed on CAC 40. *Management of Environmental Quality: An International Journal*, 28(4), 490-506.

Bianchi Martini, S., Corvino, A., Doni, F. & Rigolini, A. (2016). Relational capital disclosure, corporate reporting and company performance: Evidence from Europe. *Journal of Intellectual Capital*, 17(2), 186-217.

de Villiers, C. & van Staden, C. J. (2006). Can less environmental disclosure have a legitimising effect? Evidence from Africa. *Accounting, Organizations and Society*, 31(8), 763-781.

Dumay, J. & Hossain, M.A. (Forthcoming). Sustainability risk disclosure practices of listed companies in Australia. *Australian Accounting Review*.

Dumay, J., La Torre, M. & Farneti, F. (2018). *Developing trust through stewardship: Implications for IC, Integrated Reporting, and the EU Directive 2014/95/EU.*, paper presented at the IX Financial Reporting Workshop University of Bologna, 14-15 June, 2018.

Farneti, F., De Villiers, C. & Dumay, J. (2018). *The EU Directive on Non-Financial And Diversity Information: A New Toothless Tiger Is Born?.* Italy: Milan.

Ferraz, D.P., Lopes, I.T. & Kopliku, A. (2018). Can board diversity and choice of auditor enhance profitability? *International Journal of Business Performance Management*, 19(3), 289-306.

GRI and Global Sustainability Standards Board (2017). *Linking the GRI Standards and the European Directive on non-financial and diversity disclosure*. Amsterdam.

Honggowati, S. (2015). Value relevance of financial and non-financial information to investor decision. *Global Business and Finance Review*, 20(2), 95-104.

Jabbar, N.S. (2018). The impact of the application of the governance mechanisms on the efficiency of the audit performance and the level of disclosure in the financial reports: An applied study to a sample of companies listed in the Iraqi Stock Exchange. *Academy of Accounting and Financial Studies Journal*, 22(2).

Lo, K.Y. & Kwan, C.L. (2017). The Effect of Environmental, Social, Governance and Sustainability Initiatives on Stock Value - Examining Market Response to Initiatives Undertaken by Listed Companies.

Corporate Social Responsibility and Environmental Management, 24(6), 606-619.

Marín Andreu, L. & Ortiz-Martínez, E. (2018). Non-financial information of Spanish companies and financial evolution Social. *Responsibility Journal*. Article in Press.

Rupley, K.H., Brown, D. & Marshall S. (2017). Evolution of corporate reporting: From stand-alone corporate social responsibility reporting to integrated reporting. *Research in Accounting Regulation*, 29 (2), 172-176.

Scaltrito, D. (2016). Voluntary disclosure in Italy: Firm-specific determinants an empirical analysis of Italian listed companies. *EuroMed Journal of Business*, 11(2), 272-303.

Wang, T. (2018). Predicting Private Company Failures in Italy Using Financial and Non-financial Information. *Australian Accounting Review*. Article in Press.

Zinsou, K.M.C. (2018). Integrated or non-integrated reports: French listed companies at a crossroads? *Sustainability Accounting, Management and Policy Journal*, 9(3), 253-288.