HOW DOES EU MEMBERSHIP AFFECT NON-FINANCIAL REPORTING? EVIDENCE FROM SELECTED BALKAN COUNTRIES

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ABSTRACT
Non-financial reporting is a form of transparency disclosure where companies disclose information that is not primarily focused on their financial performance, but information related to their activities that contribute to society through environmental protection, social matters, employees, human rights, anti-corruption and other activities affecting the supply chain.
The purpose of this research is to analyze non-financial disclosure in selected Balkan countries and to determine how EU membership affects the scope of non-financial reporting. Four countries are included in the research, two of which are EU countries and two are non-EU countries. A total of 40 blue-chip companies that are part of the national stock market indexes for the period of 2019 to 2021 were taken as a sample in the research. We applied content analysis to 120 Audited Consolidated Annual Reports, individual Non-financial Disclosure Reports and all tabs and sub-tabs of official websites from which we identified variables to be statistically tested. A detailed descriptive and comparative analysis will be made to qualitatively and quantitatively describe the characteristics of non-financial reporting in the respective countries, and then the Multivariate Kruskal-Wallis will be conducted to test whether EU membership affects the extent, title, type, and length of the report on non-financial information.

Keywords: *Non-financial reporting, EU membership, Balkan countries.*

JEL classification: *M14, M40.*

1. INTRODUCTION

The connection with the environment is an essential survival tactic that makes it possible for companies to be independent, self-sufficient, and most importantly, sustainable. An organization must reduce to a minimum all negative effects, including emissions, waste, social issues, and unjust treatment of personnel, in order to achieve maximum sustainability in commercial operations. Non-financial reporting (NFR) is defined by Erkens et al. (2015) as disclosure supplied to outsiders of the organization on aspects of performance other than the typical assessment of financial performance from the perspective of shareholders and debt-holders. This concept includes, but is not limited to, things disclosed outside of financial statements pertaining to social and environmental accounting, corporate social responsibility (CSR), and intellectual capital. Non-financial information (NFI) has grown in importance as a strategic component for a company's survival and development (Ioannou & Serafeim, 2017). Therefore, a company's survival can no longer be attributed solely to an economic dimension of profit maximization; rather, it must be discussed in a broader context that takes into account how the company manages the risks associated with the long-term social and environmental impacts of its operations as well as how it exhibits social responsibility (Milne & Gray, 2007). As a result, NFI in annual reports has drawn the attention of more researchers, practitioners, and standard-setters (Manes-Rossi et al., 2018). Capital market participants, i.e. large public entities are increasingly emphasizing the value of non-financial information. By increasing the transparency and accountability of NFI, sustainability reports are a valuable instrument for boosting engagement with stakeholder groups and allow businesses to show that they are socially responsible (Patten,2014). Stakeholders are increasingly interested and demand greater consistency in promoting the culture and responsibility of companies. Banks, investors, regulators and others include non-financial factors in the rating of companies and thereby impose the need to disclose non-financial information as part of the mandatory annual reporting of companies (Deloitte, 2021). Non-financial reports fall under various headings and categories of reporting, such as integrated reports, social responsibility reports, sustainability reports, and reports on corporate social responsibility (Stolowy & Paugam, 2018).

In accordance with the European Union Directive 2014/95/EU, Public Interest Entities (PIEs) in Europe are required to prepare a "Non-financial statement" covering environmental and social issues, respect for human rights, and the fight against corruption and bribery (EU, 2014). Croatia and Slovenia, as EU member states, have implemented the provisions of the Directive into national accounting laws, making non-financial reporting mandatory. On the other hand, in North Macedonia, non-financial reporting is not legally regulated and is voluntary, but is promoted through a guide and recommendations, while in Serbia non-financial reporting is voluntary as of 2020, and from 2021 it is mandatory for large public companies.

In this regard, the purpose of this research is to ascertain the differences in non-financial reporting practices between EU countries and non-EU countries, i.e. to investigate whether blue-chip companies listed on national stock exchanges, which comprise the market stock indexes, publish non-financial information. In this research in progress paper we have identified the main variables through which we will conduct statistical testing to examine the impact of EU membership on the extent, title, type and length of the report on non-financial information. As variables we identified all recurring patterns through the detailed analysis of the reports through content analysis for each separate segment, mentioned above. The paper is divided into several sections, where we first give a brief introduction to the matter, then a literature review on which we base our research and preliminary results and research methodology perspective in which we present the preliminary results obtained and the methodology we plan to implement. Finally, we provide a brief summary of the preliminary and expected results and our goals for completing the research.

2. LITERATURE REVIEW

The expansion of reporting practices and the interest of investors show how firms are reacting to both rising regulation and cultural changes in how people view businesses' operations (Trpeska et al., 2021). The European Union Directive 2014/95/EU (European Union, 2014) on non-financial disclosure and diversity (NFRD) is changing how large European corporations report and disclose NFI on economic, social, and environmental issues. Beginning in 2017, the NFRD mandates major enterprises and organizations with more than 500 employees to include "non-financial and diversity information" in their management reports. The NFRD has a dual materiality approach, requiring enterprises to disclose not just how sustainability issues affect them, but also how their operations harm society and the environment (Christensen et al., 2021). The EU is actively examining this directive and exploring measures to improve it, such as implementing specific criteria or audit requirements (European Commission, 2020). There is interest in presenting early information regarding the changes in accounting and reporting processes due to the requirements of the EU NFRD (La Torre et al., 2020).

One of the most well-known frameworks for disclosing the economic, environmental, and social concerns facing a business is the Global Reporting Initiative (GRI) framework (Laskar, 2018). Business in The Community (BiTC), the Dow Jones Sustainability Index (DJSI), the Business Ethics 100, the AccountAbility (AA) rating (Hopkins, 2005), the International Integrated Reporting Council (IIRC), the Carbon Disclosure Project, the Sustainability Accounting Standard Board (SASB), and the Global Framework for Climate Risk Disclosures (GFCRD) are additional frameworks that have been developed (Siew et al., 2013; Emeka-Nwokeji & Osisioma, 2019).

Strict government regulation puts all companies within the mandatory limits, as laws usually provide standard rules for all organizations within a jurisdiction or category defined by law (Jackson et al., 2020). Increased transparency according to these standards reduces information asymmetries between companies and stakeholders. According to Dave (2017), social obligations should be voluntarily fulfilled rather than mandated, otherwise, the purpose of the action may be lost and the law unintentionally obeyed.

According to Johari & Komathy (2019), Europe had the greatest rate of sustainability disclosure at over 49%, followed by Asia at 15%, North America at 14%, Latin America at 12%, Oceania at 6%, and Africa at 4%. Doni et al. (2020) study the quantity and quality of NFI provided by 60 Italian companies prior to the EU NFRD to see whether their past voluntary sustainability activities influenced mandatory non-financial disclosures following the new legislation. They discover that prior, existing abilities and competence in NFR positively contribute to legislation compliance and ensure quality in NFI.

The 250 largest firms in the world (the G250), or 96% of them, reported on their sustainability performance, according to the KPMG (2020)'s Survey of Sustainability Reporting. A total of 80% of the N100, a group of 5,200 businesses made up of the 100 biggest firms in 52 nations, report NFI.

According to Deloitte (2022)'s survey, as markets continue to demand transparency, more than half of executives (57% of survey respondents) say that data availability and data quality remain their top challenges when it comes to environmental, social and governance (ESG) data disclosure. Only 21% of survey respondents currently have an ESG council or working group in

place to drive strategic attention to ESG topics, but 57% of survey respondents are actively working to establish one (Deloitte, 2022).
According to Levkov and Palamidovska-Sterjadovska (2019) research, which included 102 banks that were actively operating in the Western Balkan countries for a three-year period (2015–2017), foreign and local banks in North Macedonia achieved an equal average score for CSR reporting, while foreign banks in Serbia, Kosovo, Bosnia and Herzegovina, and Montenegro attained a higher score, i.e. a higher level of NFI disclosure. In general, their analysis demonstrates that there are discrepancies in the disclosure of CSR initiatives in various marketplaces, taking the Western Balkan Countries into consideration. In a study on the relationship between sustainability reporting and business performance, Aifuwa (2020) draws the conclusion that there is a strong correlation between these two areas.
The content analysis approach and a binary scoring method of the NFR (Branco & Rodrigues, 2006; Hinson et al., 2010; Matuszak et al., 2019; Levkov & Palamidovska-Sterjadovska, 2019; Trpeska et al., 2021) was used to identify social responsibility disclosure in annual reports and websites.

3. PRELIMINARY RESULTS AND RESEARCH METHODOLOGY PERSPECTIVE

To achieve the set goals of the research, a content analysis was conducted to identify levels and trends in NFR in four Balkan countries, two of which are EU member states: Slovenia and Croatia, and two non-EU countries: North Macedonia and Serbia. In the research, we analyzed the top 10 blue-chip companies in each country that are part of the national stock market index, i.e. companies that show the capital market movements.
The sample we used is composed of 40 companies that we analyzed for the period from 2019 to 2021. In fact, we used only secondary data that was extracted from the audited consolidated annual reports, individual non-financial disclosure reports and all tabs and sub-tabs of the official websites.
Table 1 summarizes the basic characteristics of the database from which information on the companies representing the analyzed countries was taken.

Table 1: Research sample

EU Membership	**non-EU**		**EU**	
Country	**North Macedonia**	**Serbia**	**Croatia**	**Slovenia**
Stock Exchange	Macedonian Stock Exchange	Belgrade Stock Exchange	Zagreb Stock Exchange	Ljubljana Stock Exchange
Stock Market Index	MBI10	BELEX15	CROBEX10	SBITOP
Number of companies	10	10	10	10

Source: Authors' calculation

All listed market stock indexes as of 31.12.2021 consisted of 10 companies, only BELEX15 included 15 companies, but for consistency in the research, only the first 10 companies by market capitalization were included. Due to the difference in the sector affiliation, they will be analyzed from the aspect of whether they belong to the financial sector (banks and insurance companies) or

to the real business sector (manufacturing, energetics, telecommunications, oil and gas, engineering and construction and others).
Our analysis aims to answer the following research question:

- **Is EU membership related to the scope and content of non-financial reporting (NFR)?**

For this purpose, we will use the binary scoring method to generate a score according to which we could rank the companies included in the research. The generation of points will take place according to the disclosed information. As standards of good practice and what should be included in the non-financial reporting, we use the standards set in the directive 2014/95/EU and the guidelines from the European Commission.
Table 2 summarizes the score generation methodology:

Table 2: Methodology for generating non-financial disclosure score

		"Yes"	"No"
Data availability	Qualitative non-financial data	1	0
	Quantitative non-financial data	1	0
Non-financial reporting referring to:	Environment	1	0
	Social & Employee matters	1	0
	Human rights	1	0
	Anticorruption and bribery	1	0
	Other matters	1	0
Maximum points per company per year		7	0
Maximum points per company for 3 years period (2019-2021)		21	0

Source: Authors' calculation

A company is awarded a disclosure point if it provides qualitative non-financial information, and an additional point if this information is supplemented with quantitative information. The research uses the individual segments that should be included in the NFR of companies, according to the 2014/95/EU directive. European Commission in Guidelines on non-financial reporting (methodology for reporting non-financial information) lists the key performance indicators (KPIs) according to which we will be guided in the research on whether companies will receive 1 point for fulfilling the corresponding criterion or not (EU Commission, 2017):

- ***Environment***: non-financial information related to material disclosure for the prevention and control of pollution, the impact on the environment from the use of energy, the emission of harmful particles and/or polluted water, the development of green products and services, etc.
- ***Social & Employee matters***: non-financial information related to employment matters, including consultation and/or employee participation, employment and working conditions, human capital management, health and safety at work, community relations, including the social and economic development of local communities and more.
- ***Human rights***: non-financial information related to the process for receiving and resolving complaints, as well as mitigating and providing legal remedies for human rights violations, respect for freedom of association, operations and suppliers at significant risk of human rights violations and others.
- ***Anticorruption and bribery***: non-financial information related to anti-corruption policies, procedures and standards, implementation and use of whistleblowing mechanisms, internal control processes and resources intended to prevent corruption and bribery and others.

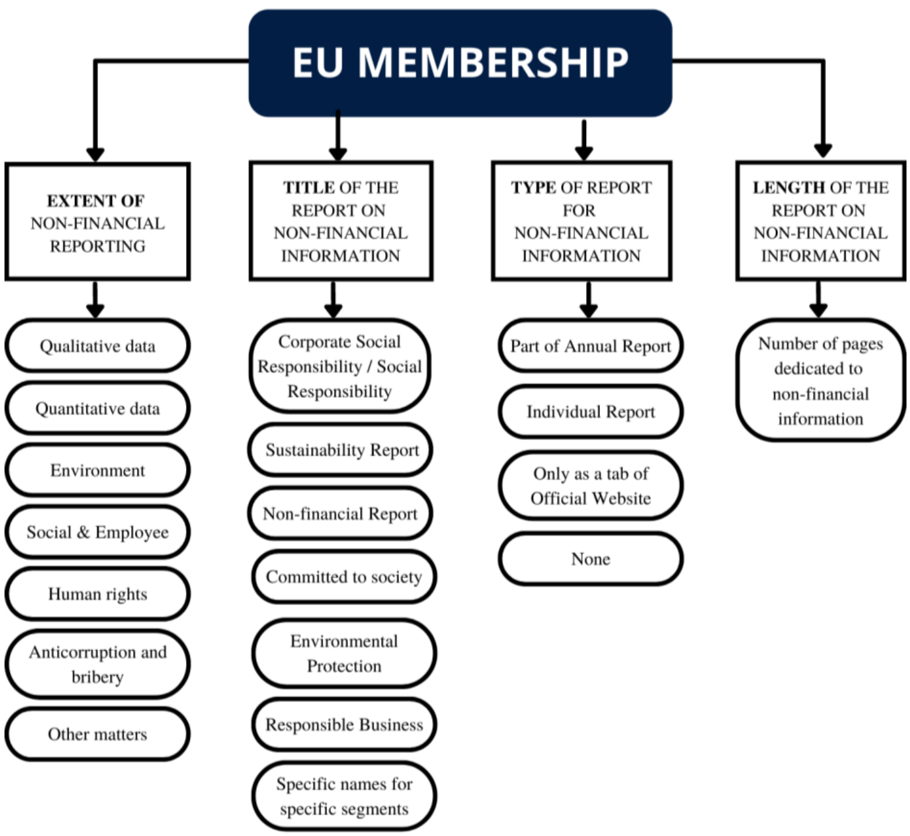
- **Other matters**: non-financial information related to labor practices, including child labor and forced labor, human trafficking and other human rights issues, deforestation and other risks related to biological diversity, Supply chains and support of domestic, small and medium-sized companies and others.

Through detailed content analysis, we tried to extract all significant segments related to NFR in order to make a comparison on non-financial information disclosure in companies between EU countries and non-EU countries. In addition to generating points based on compliance with the EU directive, several other parameters were also included in the survey in order to derive a more detailed basis with which we could answer the following set research sub-questions:

- Does EU membership affect the **extent** of non-financial reporting?
- Does EU membership affect the **title** of the report on non-financial information?
- Does EU membership affect the **type** of report for non-financial information?
- Does EU membership affect the **length** of the report on non-financial information?

By analyzing the companies' reports, we have identified several repeating patterns that we will use as variables in the statistical testing. Graphic 1 summarizes the identified variables for each segment separately which will be analyzed in detail:

Graphic 1: Variables for testing research questions



Source: Authors' calculation

Our plan is to conduct a qualitative and quantitative analysis for each segment separately in order to obtain results for the companies from respective countries. For this purpose, first we will conduct a descriptive, and comparative analysis to summarize the main characteristics of NFR in the companies for period from 2019 to 2021. Then we will conduct Multivariate Kruskal-Wallis to see the dependence and relationship between the defined dependent variables (response) and EU membership as an independent variable (factor). In the analysis to test the impact of EU membership on the extent and length of the non-financial reporting report, 120 observations will be included, i.e. data for 40 companies over a period of 3 years. To test the impact of EU membership on the title and type of the report, 12 observations will be used because the variables will be grouped according to the frequency of the titles used by the companies from the respective country and the frequency of publication method during the year (4 countries x 3 years). EU membership for statistical testing purposes will be coded with 1 = EU country and 0 = non-EU country.

4. CONCLUSION

Non-financial reporting, which is the disclosure of the activities that companies undertake to contribute to the betterment of the society, is becoming more significant and relevant for the information users and all stakeholders. It is very important to note that non-financial reporting is actually a disclosure of the activities undertaken, and not a fact about how much the companies contribute to the society in which they operate, because in practice there may be companies that contribute significantly, but do not publicly disclose information about the same. However, the EU directive and good European and World practices indicate the importance of disclosing information in order to make it publicly available. Our research refers to previously conducted research and a literature review on the relevant topic, where we aim to compare two EU countries and two non-EU countries from the Balkans, and then expand the research and include many more countries in order to reach results at the level of the entire European Union. The paper will contribute to identify the scope of NFR from the perspective of EU membership and according to our assumptions that there should be a positive impact and correlation, to extract all segments where there are differences and to give suggestions how to standardize and improve NFR according to the detailed EU directive.

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