CORPORATE GOVERNANCE IN THE COVID-19-ERA THROUGH THE PRISM OF NON-FINANCIAL REPORTING

ANDREJA PRIMEC, JERNEJ BELAK
University of Maribor,, Faculty of Economics and Business, Maribor, Slovenia
andreja.primec@um.si, jernej.belak@um.si

Abstract Non-financial reporting is undoubtedly an essential institutional measure aimed at socially responsible corporate governance and thus at the sustainable development of corporations and society in general. Large corporations were required to disclose information on non-financial performance in their 2017 financial report for the first time. The COVID-19 pandemic has caused socio-economic damage, exposed workers' vulnerability, and highlighted the fragility of supply chains. In this paper, the authors have analysed the practice of selected Slovenian corporations in non-financial reporting by observing the companies' disclosed non-financial data during the 2020 epidemic. The aim of this study is to consider how well corporations have adapted to the challenges of the COVID-19 epidemic. The results of the case study will show how the selected Slovenian corporations are striving to consider the interests of workers in their governance in times of emergencies such as the COVID-19 epidemic. Moreover, in light of the new Corporate Sustainability Reporting Directive (CSRD), these results will provide a good starting point for future research into whether the selected Slovenian corporations are on the right path towards sustainable corporate governance and/or what they need to change in this area to achieve their goals.

Keywords: Non-financial reporting, sustainability reporting, sustainable corporate governance, Directive 2014/95/EU, CSRD proposal

University of Maribor Press

DOI https://doi.org/10.18690/um.epf.5.2022.12
ISBN 978-961-286-600-6

1 Introduction

This paper focuses on introducing non-financial reporting by large corporations, which is the first legal step on the path toward corporate social responsibility. Its origins lie in the global economic crisis that occurred in the USA in 2008 and then spread to Europe. Non-financial reporting was established by Directive 2014/95/EU (NFRD) and has been implemented in practice since 2018. In addition to an overview of the development of this institution in the EU and Slovenia and its further evolution, the authors of this study have also provided a more detailed overview of its substantive requirements. A case study was undertaken to examine the non-financial reports of selected corporations in Slovenia. The main research area will thus be the content of non-financial statements of the observed companies for the period of the COVID-19 epidemic.

The answers will be used to conclude whether the existing non-financial reporting model is adequate to respond to situations such as those caused by the COVID-19 epidemic and to what extent (or how) the interests of workers as important internal stakeholders of corporations are considered in such risks. Moreover, these results will provide a good starting point for future research in relation to the new CSRD Directive. Whether or not the announced changes go in the right direction to achieve sustainable corporate governance for workers will be of particular importance. The case study results of Slovenian corporations will also be of interest to researchers of this type of issue in the other EU Member States. Since the legislation regarding non-financial reporting is harmonised, it should not cause too much divergence in practice.

2 Legal framework of non-financial reporting

The requirements introduced by the EU through Directive 2006/46/ES can be identified as a precursor to non-financial reporting. The Directive enacted measures to restore the confidence of the capital market and the general public in annual accounts and company reports following serious economic shocks and scandals (Tico, Enron, Parmalat). Enhanced and consistent specific disclosures and publication of information about company performance should contribute to improved transparency of companies' financial management. Moreover, this Directive sets out the liability of management bodies for drawing up and adopting annual reports, including their obligation to approve them with their signature. One of the central requirements of the Directive is the corporate governance statement.

The non-financial reporting obligation was introduced by Directive 2014/95/EU for certain large undertakings and groups. The main objective of this Directive is to improve social responsibility. To this end, companies should also consider social and environmental issues in managing their business operations and adapting their strategy. The transparency of the so-called 'non-financial information' may help companies better manage their non-financial risks and opportunities, thus allowing them to improve their non-financial performance and providing an important source of information for potential investors as well as for civil society when assessing the effects and risks related to the company's performance (Primec, Belak, 2017).

According to the directive, non-financial reporting consists of two parts. The first, the so-called 'diversity policy', was included in the corporate governance statement. At the same time, the other part contains an obligation for large public-interest entities to disclose non-financial information.

3 The content of non-financial reporting

3.1 Diversity policy

The demand to disclose diversity policies is seen as a renewed attempt to establish female quotas, however, this time in an autonomous act of corporate decision-making (soft law). In contrast, the effort to enforce the Directive on improving the gender balance among non-executive directors of companies listed on stock exchanges (Commission, 2012) failed.

In the EU and elsewhere in the world, there have been many studies and research into the impact of women in corporate governance structures. The main lines of enquiry are the impact of gender diversity on the governance body itself. The second line of enquiry focuses on the impact on a company's external and internal stakeholders. Furthermore, women's participation is examined from different perspectives, such as how the participation of female directors affects the effectiveness of management, the independence of the management body, and the professionalism of decision-making.

Individual studies have also addressed women's participation in strengthening corporate social responsibility, which has quickly become a subject of policy debate (Kang et al., 2007) or even global discussion (Rao, Tilt, 2016). Most authors studying gender diversity have found apparent differences in values and thinking between men and women. Traits such as assertiveness, aggressiveness, independence, self-confidence and competitiveness are generally present in men, while a sense of caring, shared interests, helpfulness, resignation and receptivity predominate in women (Eagly, Johannesen, Van Ensen, 2003). Women tend to occupy positions in softer management areas, such as human resources management, corporate social responsibility and marketing (Zelechowski, Bilimoria, 2006).

However, the widespread political aspirations for fair, balanced and sustainable development of the global economy, which can be achieved through socially responsible governance, convincingly demonstrate that the political capital of women's quotas cannot be doubted.

3.2 Non-financial statement

To enhance the consistency and comparability of non-financial information disclosed throughout the Union, a non-financial statement should contain information relating to, at the minimum, environmental matters, social and employee-related issues, respect for human rights, anti-corruption and bribery. Such a statement should include a description of the policies, outcomes and risks related to those matters and should be contained in the management report of the undertaking concerned. The non-financial statement should also include information on the due diligence processes implemented by the undertaking, including, where relevant and proportionate, its supply and subcontracting chains to identify, prevent and mitigate existing and potential adverse impacts (NFRD, point 6 of the Introduction).

The information listed above relates to the previous financial year. If the company does not apply any of the above policies, it must provide a clear and reasoned explanation in the statement of non-financial performance. The disclosure of non-financial information relies on the 'comply or explain' principle.

3.3 Non-financial reporting de lege ferenda

Since its harmonisation efforts do not cover integrated reporting and third-party assurance, the Directive falls short in facilitating comparability and reliability, and thus reporting utility. The main weaknesses of the Directive can be divided into two categories: (i) lack of harmonisation in terms of integrated reporting and assurance and (ii) an excess of possibilities for companies to deviate from reporting requirements (De Roo, 2015). To prevent non-financial reporting from becoming a self-serving exercise, two elements are crucial: i) the assessment of materiality needs to follow a robust process, in which the methodology to define which non-financial information is material becomes critical; and ii) the disclosure of non-financial information should be perceived as beneficial by companies (Commission, 2020).

In addition, there is a growing demand for more comprehensive and contextual information. Investors need to know what risks they can expect, in particular due to the requirements of the new legislation, including Regulation (EU) 2019/2088 (Sustainable Finance Disclosure Regulation) and Regulation (EU) 2020/852 (Taxonomy Regulation).

The Commission has proposed a new legislative act – Corporate Sustainability Reporting Directive – to safeguard these interests (CSRD, Commission, 2021). The CSRD extends the scope to all large companies and companies listed on regulated markets (except listed micro-enterprises) established within the EU or outside the EU, but with the subsidiaries listed on an EU regulated market. Since the NFRD did not specify any standards on how information should be disclosed, the CSRD prescribes the standard for non-information disclosure. The information must be disclosed in the annual report, in the same place as the financial information. The sustainability information should be verified by external auditors. The Commission will adopt delegated acts to provide for sustainability reporting standards.

4 Research carried out and an overview of the results and findings

Eleven companies were examined during the course of this case study research. The main data source for this study involved a predesigned methodology, which was applied during the examination of the annual reports of the 11 companies, all of which are listed on the Slovenian stock exchange. The case study took place in March

2022, observing the annual reports of the examined companies for the year 2020 in Slovenia.

In the first part of the presented research, the authors examined the diversity policy, following the legal frame and legal obligations of diversity policy reporting. After examining the diversity policy, all the companies were examined in the context of the non-financial statement. Again, tjos study followed the legal reporting requirements for companies' non-financial statements.

Table 1 illustrates the research results on the diversity policy of the examined companies.

Table 1: Diversity policy

1.	Does the company have a defined diversity policy?
	YES: 11 NO: 0
2.	Does the company ensure diversity in its management and supervisory bodies?
-	Gender: YES: 9 NO: 2
-	Age: YES: 9 NO: 2
-	Education: YES: 11 NO: 0
3.	Does the declaration on diversity policy contain all the information required (i.e. it is adequate, partially adequate, inadequate), describing it in words and illustrating it with concrete examples (see questions 2, 3, 4 for details)?
	a) CONSISTENT: 5
	b) PARTIALLY CONSISTENT: 5
	c) INCONSISTENT: 1
4.	Is the diversity policy implemented in the observed company? YES: 11 NO: 0

Observing the table above, it can be stated that all 11 observed companies have a clearly defined diversity policy, while nine companies ensure such diversity in their management and supervisory bodies based upon gender and age, and all 11 companies ensure diversity in their management supervisory bodies as well as in terms of educational matter. However, the research showed that two companies do not apply such diversity in their management and supervisory bodies based upon gender or age.

Observing the consistency of the examined diversity policies with the required information (based on the legislation), this research showed that out of 11 examined companies, only five diversity policies of the examined companies were consistent with the legislative requirements, whereas five diversity policies were partially consistent and one policy was inconsistent with the legislative requirements, while all 11 diversity policies – as they were developed – were also implemented in the observed companies.

Table 2 shows the research results on the non-financial statement of the observed companies.

Table 2: Non-financial statement

1.	Does the company have a non-financial statement?
	YES:10 NO: 1
2.	Does the company's non-financial statement contain all the required information (see answers to questions 3 to 9)?
a) b) c)	CONSISTENT: 9 PARTIALLY CONSISTENT: 1 INCONSISTENT: 1
3.	Does the company's non-financial statement disclose information on:
	a) Environmental matters YES: 11 NO: 0 b) Social matters YES: 11 NO: 0 c) Human resource matters YES: 11 NO: 0 d) Respect for human rights YES: 10 NO: 1 e) Anti-corruption and anti-bribery matters YES: 9 NO: 2
4.	Does the company's non-financial statement include a brief description of the existing business model?
	YES: 8 NO: 3
5.	Does the company's non-financial statement include a description of the company's policies on the matters referred to in question 3 (environmental, social, human resources, etc.)?
	YES: 11 NO: 0
6.	Does the company's non-financial statement include a description of implementing the company's due diligence procedures concerning the above policies?
	YES: 10 NO: 1
7.	Does the company's non-financial statement include a description of:
	a) the results of those policies YES: 11 NO:0 b) the principal risks concerning those matters associated with the company's activities

	YES: 9 NO: 2 c) including, where appropriate and proportionate, the company's business relationships, products or services that could cause serious adverse effects in those areas YES: 7 NO: 4 d) how the company manages the above risks YES: 10 NO: 1
8.	Does the company's non-financial statement include key non-financial performance indicators relevant to individual activities?
	YES: 9 NO: 2
9.	If the company under review does not apply any of the above policies, it must provide a clear and reasoned explanation in the company's non-financial statement.
	YES: 5 NO: 6
10.	Does the audited company refer to the accounting part of the annual report in its non-financial statement?
	YES: 3 NO: 8

Observing the table above, it can be state that 10 of the observed companies have a non-financial statement, whereas one company does not follow the legislative requirements.

Observing the consistency of the examined non-financial statements with the required information (based on the legislation), this research showed that out of 11 companies examined, nine of the non-financial statements were consistent with the legislative requirements, while one non-financial statement was partially consistent and one non-financial statement was inconsistent with the legislative requirements. Furthermore, this research showed that all 11 of the observed non-financial statements disclose information on environmental, social and human resource matters, while only 10 companies disclose information on respect for human rights and the disclosure of information on anti-corruption and anti-bribery matters is only present in nine of the observed non-financial statements.

This research showed that only eight of observed non-financial statements include a brief description of the existing business model. All 11 of the observed non-financial statements include a description of the company's environmental, social, human resources policies, etc. Furthermore, only one non-financial statement does not include a description of implementing the company's due diligence procedures concerning the above policies.

The above table shows that all 11 of the observed non-financial statements also include the results of the policies mentioned above, while only nine statements define the principal risks concerning those matters associated with the company's activities. Furthermore, only seven non-financial statements include information on the company's business relationships, products or services that could cause serious adverse effects in the aforementioned areas, and 10 observed statements include how the company manages such risks.

Furthermore, the research showed that nine of the observed non-financial statements also include key non-financial performance indicators relevant to certain activities of the company, whereas six of the observed non-financial statements do not provide a clear and reasoned explanation for not applying the aforementioned policies. Furthermore, it can be observed that only three of the observed non-financial statements refer to the accounting part of the companies' annual reports.

5 Conclusions

The case study research showed that the state of the companies examined in terms of non-financial reporting is, in general, good. However, the research highlighted some deficiencies in the companies' non-financial reporting.

In the context of diversity policy, it can be observed that there are some deficiencies in companies' desire and preparedness to implement gender and age diversity. The research also showed that companies that do not ensure age and gender diversity do not explain the main reasons for such a condition. This results in partially consistent or inconsistent content of such diversity policies.

This research showed a similar condition in terms of the non-financial statement of the examined companies. The non-financial statement is mainly present and reported by all companies. However, the lack of substantive reporting to explain the reasons for the non-presence of a certain policy is worrying. The research showed a lack of disclosed information on respect for human rights and anti-corruption and anti-bribery matters. Surprisingly, this study showed that some of the enterprises examined do not explain their risk policies and mainly did not refer to their non-financial statements with the accounting part of their annual reports, which diminishes the transparency of the companies' non-financial projects and activities.

Considering the above, it can be argued that due to the lack of substantive reporting, the quality and usefulness of such reporting is diminished. It does not deliver holistic information to all stakeholders to enable them to assess the quality of corporate governance in a certain company. This is also why, unfortunately, it is not possible to draw any firm conclusions on the influence of the COVID pandemic on the corporate governance of the observed companies, which was also one of the focuses of this research.

The above clearly shows that companies have not yet qualitatively approached non-financial reporting, however, they are still striving to 'tick the box' and ad hoc reporting. This makes the new CSRD with the prescribed standards on non-financial information of great importance for Slovenian companies. In addition to disclosing more valuable non-financial information for stakeholders, it will force companies to disclose data based on the increasingly challenging requirements established with other legal acts, such as the Sustainable Finance Disclosure Regulation and the Taxonomy Regulation. These legal obligations would also lead to planning, organising, managing and controlling the 'non-financial' activities and projects on the path to a socially responsible and sustainable company. This can be understood as a step forward to sustainable corporative governance and management.

References

Commission (2012). Proposal for a Directive of the European Parliament and the Council on improving the gender balance among non-executive directors of companies listed on stock exchanges and related measures. https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52012PC0614 24. 3. 2022.

Commission (2021). Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting. https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:52021PC0189 24. 3. 2022.

Commission (2020). Study on the Non-Financial Reporting Directive. https://op.europa.eu/en/publication-detail/-/publication/1ef8fe0e-98e1-11eb-b85c-01aa75ed71a1/language-en (25. 3. 2022).

Eagly, A.H., Johannesen-Schmidt, M. C., Van Engen, M. L. (2003). Transformational, Transactional, and Laissez-Faire Leadership Styles: A Meta-Analysis Comparing Women and Men. *Psychological Bulletin*, 129: 569–591.

Eels R., Walton C. (1974). *Conceptual foundations of business (3rd ed.).* Burr Ridge: Richard D. Irwin.

Maak, T. (2008). Undivided corporate responsibility: Towards a theory of corporate integrity, *Journal of Business Ethics,* Vol. *82, No. 3*, 353–368.

Marrewijk, M, (2003). Concepts and Definitions of CSR and Corporate Sustainability: Between Agency and Communion. Journal of Business Ethics 44(2):95-105, DOI: 10.1023/A:1023331212247

Primec A., Belak J. (2017). Corporate governance and management: institutional and formal approach for achieving socially responsible and corporate governance of a higher quality. V: *The paradoxes of leadership and governance in the postmodern society*. 5th International OFEL Conference on Corporate Governance, Management and Entrepreneurship, 7th - 8th April 2017, Dubrovnik, Croatia. Zagreb: CIRU - Governance Research and Development Centre, 2017. Str. 154-164.

Rao K., Tilt C. (2016). Board Composition and Corporate Social Responsibility: The Role of Diversity, Gender, Strategy and Decision Making. *Journal of Business Ethics*, 138(2): 327–347.

De Roo, K. H. (2015). Role of the EU directive on non-financial disclosure in human rights reporting, the. European Company Law, 12(6), 278-285.

Zelechowski, S., Bilimoria, D. (2006). Characteristics of CEOs and boards with women inside directors. *Corporate Board: role, duties and composition*, 2(2), str. 14–21.