Scientific Review
UDK: 657.3
Paper received: 18/07/2017
Paper Accepted: 25/08/2017

NON-FINANCIAL REPORTING AS A NEW TREND IN SUSTAINABILITY ACCOUNTING

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ABSTRACT

The non-financial reporting trend is expected to continue and grow as corporate stakeholders demand more information concerning environmental, social, and governance impacts. Hence, understanding the importance of sustainability accounting plays a pivotal role in offering stakeholders information that is more reliable and accurate. According to a Governance & Accountability Institute, 82% of the S&P 500 companies published Corporate Sustainability Reports in 2016.

Dilemma for the business is no longer whether having a non-financial report or not, it is rather why, how and which report or option should companies choose to meet stakeholders needs and comply with the regulatory framework. The objectives of this paper are as follows: first, overview of the non-financial reporting and sustainability accounting, then its historical development will be presented. Finally, this paper will provide an overview on the new European legislative framework of non-financial reporting which will be presented and described.

Key words: *non-financial report, history of non-financial reports, sustainability accounting, non-financial report legislation in European Union*

1. INTRODUCTION

Current rate of corporate responsibility (CR) reports among the world's largest companies (G250) is over 90 percent, what presents s new trend of sustainability accounting (KPMG, 2015). With the EU Directive on non-financial reporting it is possible to notice a rapid increase in the volume of regulations and normative requiring transparency on environmental, social, governance (ESG) issues. Data from eRevalue's Observe database shows that between 2010 and 2016 the volume of regulatory initiatives concerning ESG transparency has increased by 64%. It is the case of the King III Code of Governance Principles in South Africa, the UK Companies Act, the Sarbanes-Oxley Act in the US, the Grenelle II Act in France, and the EU Directive 2014/95/EU. The latest KPMG Survey of Corporate Responsibility Reporting (KPMG, 2015) indicates that legislative initiatives by governments and stock exchanges are the main driver of such kind of reporting. More than two-thirds of the Fortune Global 500 companies issue a sustainability report (LeBlanc, 2012), showing a growing trend that is not prompted by contingent and temporary forces (Kolk, 2004). Sustainability reporting is also growing in emerging economies, in particular in the Asia Pacific area and Latin America, however the gap between leading and lagging industry sectors is narrowing too, converting sustainability reporting in a diffused and cross-sectorial practice (KPMG, 2015).

This is the manifestation of a wide and shared consensus that ESG data reporting offers a contribution towards the integration of sustainable development principles at business level and sustainability accounting. The integration of sustainability at accounting was based on the quantification of the ESG or social and environmental data. During time the quantification of ESG data resulted in development of sophisticated and internationally accepted non-financial reporting frameworks, tools and software.

2. NON-FINANCIAL REPORTING AND SUSTAINABILITY ACCOUNTING

Discourses regarding ESG accounting and reporting began as soon as the idea of an extended corporate responsibility was introduced, as presented in more detail in the next section. This coupling is not casual, but refers to the inherent raison d'être of accounting.

To perform accounting, it is necessary to create and establish data collection systems, databases, and associated reporting processes. A broadened accountability towards a wider array of stakeholders implies that their claims and interests find representation in such systems. As a consequence, accountability towards stakeholders needs the construction of an adequate accounting and reporting system, incorporating stakeholders' voices in its records, translating them into reliable, systematic, and accountable measurements (Hall et al., 2015).

Specifically, accounting consists of 4 basic processes: counting, recording, summarizing, and reporting (Goldberg, 1965). In particular, counting regards identification and measurement of relevant facts or phenomena. Recording refers to the translation of such measurements accordingly to the conventions of accounting principles. The resulting accounting data is then ordered to add meaning to it. For example, the summarizing process distinguishes between current and long-term liabilities and assets and calculates net accounts. The final process of reporting deals with communicating the information to relevant internal and external audiences, allowing the readers to assess, compare, evaluate, and analyze it.

As it is evident, reporting is only a limited portion of accounting, which more importantly regards constructing what is known by an organization, as showed by Mitchell, et al. (2015). According to this perspective, the path leading to knowledge begins with observation of phenomena – "facts" (Ackoff, 1989) - in a process of identification and measurement that clearly resonates the counting basic process. With the association of conventionally defined symbols to facts, they evolve into data (Ackoff, 1989; Davis, 1974). This is precisely what happens when applying the recording conventions prescribed by accounting standards in the recording basic process. Then, the infusion of meaning to data generates information (Checkland & Scholes, 1990; Davenport & Prusak, 1998; Davis, 1974; Drucker, 1988; Tushman & Nadler, 1978). In accounting, this step is carried out through the summarizing basic process, which generates the accounts conveying informative value. Finally, the transition from information to knowledge requires the application of information (Davenport & Prusak, 1998; Kuhlen, 1991; Nonaka & Takeuchi, 1995). The reporting basic process enables application of the accounting information for auditing, analysis, disclosure, and decision-making purposes.

In this perspective, accounting serves to create the space of what can be known by the organization, in turn defining what is manageable or not. It is a language familiar to firms, allowing them to "speak" and "listen" to stakeholders (Hall et al., 2015). In particular, an accounting language affects how managers form their views about what needs to be done, by operationalizing ideas and approaches and creating specific visibilities in the information (Burchell et al., 1997; Chapman et al., 2009; Miller & Power, 2013). Conversely, it contributes to constructing stakeholder's image, perception, and judgement concerning the organization (Cooper & Owen, 2007; Freeman et al., 2010; Zadek et al., 2013). In addition, it brings claimants together in this cognizable and manageable space (Crane et al., 2015).

In other words, the language of non-financial reporting which presents company's ESG performance reflects an extended accountability towards more demanded stakeholders. More precisely, non-financial reporting builds a transformative accounting in opposition to a conservative, business-as-usual one.

Stakeholders' representation in accounting has a normative value in the sense that it changes the power relationships between the company and its surrounding environment (Harrison & van der Laan Smith, 2015).

The normative foundations of stakeholder accounting rely on a general principle of fairness (Phillips, 2003), according to which accountability towards stakeholders and their right to access to created value depends on the extent of their contributions of resources to the firm. In this sense, stakeholders have a tacit contract with the firm, implicitly investing in non-monetary terms and expecting a return on such investment. They bring a residual claim to the value created thanks to their contribution. Clearly, they bear a form of risk in relation to their investment. Hence, according to the principle of participation to value creation deriving from voluntary risk-taking, accountability towards stakeholder is not different from accountability towards provider of financial capital (Harrison & van der Laan Smith, 2015; Mitchell et al., 2015).

Harrison and Van der Laan Smith (2015, p. 941) sum up effectively this rationale, "our normative argument, from an external reporting perspective, is that non-financial stakeholder groups that contribute significant resources to the corporation are as worthy of receiving reliable information (on a regular basis) that will help them to mitigate their risks (residual and otherwise) as are those stakeholder groups that supply financial capital to the firm."

In this perspective, sustainability reporting becomes an institutionalised practice contributing in building the necessary knowledge for voluntary risk-taking for all the actors involved in the value creation process. Hence, as Mitchell et al. (2015) put it, the problem of stakeholder inclusion/exclusion in accounting is one of knowing vs not knowing.

3. HISTORY OF NON-FINANCIAL REPORTING

Social and political environment, as well as technological and natural changes have influenced the development of corporation's business and thus their external reporting. With the industrial revolution at the beginning of the 19th century, the concern of corporations on social responsibility of women's rights and social inequalities of employees which became the focus of corporate reporting. Carroll and Buchholtz (2012) states that this are the first examples of corporate social responsibility or non-financial reports across the European companies: German companies had to adjust their financial statements to the social reports (germ. Sozialbilanz), France introduced a law requiring the publication of social reports (fran. Budget social) of large corporations, in which it was necessary to describe the conditions of work and education of employees as well as the work safety policy. In the UK, the social audit movement known as Social audits has resulted with the first attempts of standardizing social reporting in order to make corporate social responsibility reports a useful tool which provides stakeholders a useful measurable indicator of corporate performance (Markota Vukić, 2016). It is possible to conclude that challenge of measuring non-financial performance of the company created a need to replace the traditional way of collecting data with a narrative reporting form. The environment issues and the first environmental reports appeared relevant to the company later in the 1990s with published articles about industrial pollution and connection to the natural disasters. Some countries realized that certain industries are excessively polluting the environment which followed by and legal regulations on environment protection in the Scandinavian countries, the United States, Australia, and Western European countries such as Germany, the UK and the Netherlands.

The expansion of the reporting domain of socially responsible reports to the environment resulted in the emergence of an environmental management system and the growth of standardization and regulation such as EMAS or ISO 14000 and AA1000 reports, resulting in a rise in the quality and quantity of published data in the company's reports (Schreck, 2013). Better quality data could be compared and used to track and evaluate corporate success in the area of social and environmental responsibility. The Earth Summit in Rio de Janeiro in 1992 launched the wave of detailed corporate reporting on environment issues. With the Rio+10 Summit on Sustainable Development in Johannesburg in 2002 decreased the number of company's environment reports and increases the number of sustainable development, corporate social responsibility and triple bottom line reports. The term triple bottom line was presented by the John Elkington (1998) which concept is to provide comprehensive information about business to all interested stakeholders. In the 2015 by adoption the Directive of non-financial reporting 2014/95/EU, in the most of the European countries the terminology of sustainable development, corporate social responsibility and triple bottom line reports began to refer to the concept of non-financial reporting.

According to the ACCA (2013) study, 92% of investors agree that financial and non-financial information should be integrated, what is becoming a new business trend as most of the non-financial information are disclosed together with the financial statements (Soderstrom, 2013).

The biggest challenge is measuring and gathering non-financial data across the business procedures and geographical prevalence. With today's technological improvements, software packages, and information and management control systems non-financial measures made their first entrance in the accounting systems through the popular Balanced Scorecard, firstly introduced by Kaplan and Norton (1996). According to Otley (2003) accounting systems do not disregard non-financial dimensions anymore.

4. EU NON-FINANCIAL REPORTING DIRECTIVE AND RECOMMENDED REPORTING FRAMEWORKS

In the resolutions from 2013, "Corporate Social Responsibility: accountable, transparent and responsible business behaviour and sustainable growth" and "Corporate Social Responsibility: promoting society's interests and a route to sustainable and inclusive recovery", the European Parliament called on the Commission to bring forward a legislative proposal on the disclosure of non-financial (or ESG) information. The main challenge was to take account of the multidimensional nature of corporate social responsibility (CSR) matched by a sufficient level of comparability to meet the needs of investors and other stakeholders as well as the need to provide consumers with easy access to information. Disclosure of ESG information, by presenting a legislative proposal was reiterated in the document "A renewed EU strategy 2011-2014 for Corporate Social Responsibility", which reached a political agreement on the Directive 2014/95/EU "The EU Non-financial reporting Directive" adopted in 2014.

4.1. THE SCOPE AND THE CONTENT OF NON-FINANCIAL DISCLOSURE REQUIREMENTS

The scope for non-financial disclosure is public-interest companies with an average number of employees in excess of 500, in the case of a group on a consolidated basis. This obligation to disclose a non-financial statement should apply to those public-interest entities which are parent undertakings of a large group.

In order to increase a further improvement to the transparency of company's non-financial information, according to the Non-financial reporting Directive the non-financial statement or the management report should contain information necessary for an understanding of the company's development, performance, position and impact of its activity, relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters, including (Directive 2014/95/EU): a brief description of the undertaking's business model; a description of the policies pursued by the undertaking in relation to those matters, including due diligence processes implemented; the outcome of those policies; the principal risks related to those matters linked to the undertaking's operations including, where relevant and proportionate, its business relationships, products or services which are likely to cause adverse impacts in those areas, and how the undertaking manages those risks; non-financial key performance indicators relevant to the particular business.

Where the companies do not pursue policies in relation to one or more of those matters, the non-financial statement shall provide a clear and reasoned explanation for not doing so. Non-compliance with non-financial reporting policies should be explained in the report and market-sensitive information protection is permitted. Directive has allowed Member States to option that any information relating to developments or in negotiation to be omitted with the duly justified opinion of the members of the administrative, management and supervisory bodies (Directive 2014/95/EU).

4.2. ASSURANCE OF THE NON-FINANCIAL STATEMENTS

Statutory auditors and audit firms should only check that the non-financial statement or the separate report has been provided. However, the Directive of non-financial reporting gave the option for Member States to require from the companies that the information included in the non-financial statement or in the separate report is verified by an independent assurance services provider.

4.3. RECOMMENDED FRAMEWORKS FOR NON-FINANCIAL REPORTING

There is a wide range of recommended frameworks from which companies can choose a tool for non-financial report that are not legally binding, but provide necessary and helpful guidance while drafting a report. The non-financial reporting frameworks are initiatives which are jointly seeking to help the organization in non-financial reporting by ensuring legitimacy, clarity of standards, functionality, learning and engagement, clear communication and significance.

According to the Non-financial reporting Directive, in providing the non-financial information companies may rely on national frameworks, Union-based frameworks such as the Eco-Management and Audit Scheme (EMAS), or international frameworks. International frameworks for non-financial reporting are: the United Nations (UN) Global Compact, the Guiding Principles on Business and Human Rights implementing the UN "Protect, Respect and Remedy" Framework, the Organisation for Economic Co-operation and Development

(OECD) Guidelines for Multinational Enterprises, the International Organisation for Standardisation's ISO 26000, the International Labour Organisation's Tripartite Declaration of principles concerning multinational enterprises and social policy, the Global Reporting Initiative. If a reporting company relies on a specific framework (national, European or international), it must state it in its report.

Below in the chapter is a brief summary of the most common non-financial reporting initiatives, frameworks and systems for corporate social responsibility management.

4.3.1. United Nations Global Compact (UNGC)

The United Nations Global Compact is a voluntary and strategic initiative to encourage companies to align their business strategy with ten principles in the area of human rights, working conditions, ecology and anti-corruption based on the United Nations Declaration and Convention, including the Millennium Development Goals. The signatories of the UNGC are obliged to issue a progress report, and to the stakeholder's public announcement on progress in the implementation of ten principles. Violation or omission of promotion may result in company categorization in the one who does not communicate and eventually may lead to ejection (Markota Vukić, 2013). UNGC has s goal to help companies around the world to build a social and environmental framework that will support and secure the survival of open and free markets, while allowing all people to have Benefits from the new global economy.

4.3.2. The Organisation for Economic Co-operation and Development (OECD) Guidelines for Multinational Enterprises

OECD Guidelines are recommendations from governments of member states and organizations and affiliated members of multinational corporations on responsible business conduct abroad and include business issues from ten areas. Guidelines propose socially responsible activities to multinational companies to improve the lives of each individual by addressing issues of employment, human rights, ecology, corruption, market competition, the publicity of data, technology and tax policy. OECD member governments and non-OECD member countries from all over the world encourage companies to respect these guidelines. The OECD Guidelines are not binding, but multinational corporations are expected to adhere them.

4.3.3. ISO 26000

ISO 26000 is a voluntary standard (guidelines) developed by the International Organization for Standardization (ISO) in order to provide a standard for socially responsible business. Companies are given definitions, guidelines and guidelines which can be easily and effectively implemented in their business. This standard was created as a result of international co-operation between government representatives, non-governmental organizations, various industries, consumer groups and trade unions from all over the world. ISO 26000 standardizes 7 core areas: (1) Organizational Management, (2) Human Rights, (3) Working Conditions, (4) Ecology, (5) Fair Business Practice, (6) Consumer Issues, and (7) Participation and Development community. It applies not only to trading companies, but to all types of organizations, regardless of their activity, size and location, as well as governments, regardless of the degree of development of their country. This standard is often referred to in the Tripartite Declaration of the International Labor Organization, the OECD Guidelines for Multinational Enterprises and UN's Leading Principles on Entrepreneurship and Human Rights and its Global Compact Initiative.

4.3.4. Global reporting initiative (GRI)

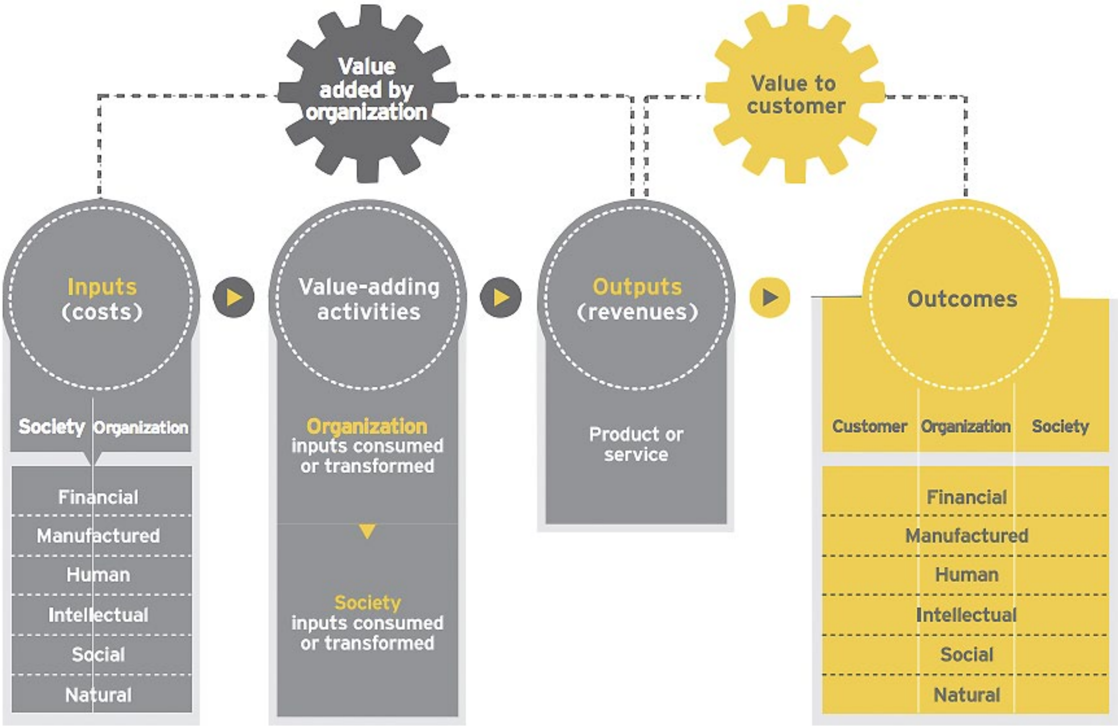
GRI is an independent international organization launched in 1997 by the Environmentally Responsible Coalition (CERES) and the UN Environmental Program (UNEP) with the mission to support companies to make decisions about the sustainable development of their business.

Current GRI Standards are the latest version of reporting framework published in October 2016 which is a result of comprehensive dialogue and collaboration with multiple stakeholders. GRI Standards are interconnected set of modules which organizations can apply for reporting on its material social, environmental and economic impacts. GRI frameworks give the highest importance to the identification and reporting of only material aspects of business operations which is identified through dialogue with key stakeholders. GRI Guidelines are currently the most comprehensive and influential framework of non-financial reporting.

4.3.5. International Integrated Reporting Council (IIRC)

Integrated reporting is a concept of creating an articulated and broader range of measures that contribute to long-term value and the role organizations play in society. According to the concept of integrated reporting helps businesses to integrate financial and non-financial business information in order to promote communication about value creation and its business model.

Picture 1.: Integrated reporting business model of interaction with internal and external capitals



Source: Ernst & Young Global Limited (2014), Integrated reporting Elevating value, adapted from IIRC, "Interaction of business model with internal and external capitals", March 2013, available at: http://www.ey.com/Publication/vwLUAssets/EY-Integrated-reporting/$FILE/EY-Integrated-reporting.pdf (date of access: 24.08.2017.)

The IIRC is developing the International <IR> Framework primarily focused to investors to make decisions about long-term investments. This framework enables business world to simplify communicating its value which creates over time. Integrated reporting is still in development, but more and more organizations decide to report on integrated way.

4.3.6. The Sustainability Accounting Standards Bord (SASB)

The SASB Foundation is an U.S. based organization with the purpose of establishing industry-based sustainability accounting standards for the recognition, disclosure and benchmark of material environmental, social and governance impacts by companies traded on U.S. exchanges. Its sustainability accounting standards enable comparison of peer performance and within an industry, SASB is developing industry-specific sustainability standards that enable a company to characterize their performance with respect to the issue. (Carrots and Sticks, 2013)

5. CONCLUSION

With provisions of the EU Non-financial reporting Directive across the EU Member states the importance of business information on sustainability such as ESG data has been increased. In order to identify business risks and increase investor and consumer trust, disclosure of non-financial information is vital for managing change towards a sustainable global economy by combining social justice and environmental protection. In this context, disclosure of non-financial information helps the measuring, monitoring and managing business performance and as such the sustainability accounting.

The scope, content and assurance of the EU Non-financial reporting Directive is a significant step for development of the sustainability accounting. Also, it is promising that European Commission will monitor the implementation of the Non-financial reporting Directive and will produce a report on its implementation by 6 December 2018, which shall include possibility of drafting a reviewed legislative proposal.

It is possible to conclude that legislation and market trends are putting strong pressure on the development of the sustainability accounting, which is already a widely accepted trend in modern accounting practice.

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NEFINANCIJSKO IZVJEŠTAVANJE KAO NOVI TREND U RAČUNOVODSTVU ODRŽIVOG RAZVOJA

SAŽETAK RADA:

Trend nefinancijskog izvještavanja će vjerojatno nastaviti rasti budući da korporativni udioničari zahtijevaju više informacija vezanih za učinke na okoliš, društvo i upravljanje. Stoga, razumijevanje važnosti računovodstva održivog razvoja igra važnu ulogu pri pružanju informacija koje trebaju biti pouzdanije i točne. Prema podacima Instituta za upravljanje i računovodstvo 82% *S&P 500 companies* objavile su izvješća o korporativnom održivom razvoju u 2016.

Dilema tvrtke više nije imati ili nemati nefinancijsko izvješće, nego zašto, kako i koje izvješće i koju opciju tvrtka treba odabrati kako bi zadovoljila potrebe udioničara i uskladila svoje propise s pravnim okvirom. Cilj ovog rada je dati pregled nefinancijskog izvještavanja i računovodstva održivog razvoja, uključujući i povijesni pregled. Na kraju rada daje se pregled novog Europskog pravnog okvira nefinancijskog izvještavanja.

Ključne riječi: *nefinancijsko izvješće, povijest nefinancijskih izvješća, računovodstvo održivog razvoja, pravni propisi o nefinancijskom izvješćivanju Europske Unije.*