

Institutional prerequisites for the development of a non-financial reporting organization model in countries with lower-middle-income economies (the case of Ukraine)

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ABSTRACT

Purpose: The creation of favourable conditions on the part of the state for the introduction of approaches to responsible business conduct ensures that the development of the national accounting system is in line with modern trends adopted throughout the world. However, adaptation is impossible without proper scientific-analytical and methodological support. Scientific and analytical support of the adaptation process requires constant, consistent and planned work to assess the translation of European legislation into Ukrainian; implementation of a comprehensive comparative analysis of current legislation in accounting with international approaches to the disclosure of information in non-financial reporting.

Methodology: The work aims to explore the best practices of forming the institutional framework for non-financial reporting of enterprises, which governments of low-middle economy countries can successfully implement. The object of research is international and national regulations and framework documents in the non-financial reporting of enterprises. **Practical Implications:** The value of the work is the creation of institutional preconditions for spreading the concept of corporate social responsibility among Ukrainian enterprises, which will increase the favourable business environment of the country and the efficiency of state resources management. The best world practice of non-financial reporting regulation was analyzed to achieve this goal. In addition, the basic principles of formalizing the mechanism of collecting and processing data on non-financial reporting of Ukrainian enterprises through the prism of international experience were studied.

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1. INTRODUCTION

The creation of favourable conditions on the part of the state for the introduction of approaches to responsible business conduct ensures that the development of the national accounting system is in line with modern trends in world experience in this field. However, adaptation is impossible without proper scientific-analytical and methodological support. Scientific and analytical support of the adaptation process requires constant, consistent and planned work to assess the translation of European legislation into Ukrainian; implementation of a comprehensive comparative analysis of current legislation in accounting with international approaches to the disclosure of information in non-financial reporting.

In the conditions of implementation of EU directive requirements in Ukraine, non-financial reporting of enterprises was introduced at the legislative level by enshrining the relevant provisions in

the following legal acts: Law of Ukraine "On Accounting and Financial Reporting in Ukraine" of 16.07.1999 № 996-XIV, Cabinet Resolution Ministers of Ukraine "On approval of the Procedure for submission of financial statements" dated 28.02.2000 № 419; Order of the Ministry of Finance of Ukraine dated 07.12.2018 № 982 "On approval of the Guidelines for the preparation of the management report". These documents define the conceptual basis for the disclosure of information by enterprises about the non-financial side of activities.

LITERATURE REVIEW

Many researchers have addressed the issue of assessing the national institutional environment and addressing the challenges associated with the implementation of non-financial reporting among EU and Asian enterprises. For example, researchers analyzed the state of disclosure of non-financial information of companies in the context of the performance of EU directive requirements (Directive 2014/95/EU), which showed that among 680 enterprises, only 246 entities disclose ESG information completely. In addition, the issues revealed include a description of CSR policy, development of intellectual capital, environmental protection, activities within sustainable development, and ethical values.

The quality of data disclosed in non-financial reporting is an essential factor influencing the effectiveness of the decision-making process, in particular, at the level of individual stakeholders, the state level, and the international level (Popescu and Bante, 2019). The following directions for research can be found in scientific papers: factors of influence (Brammer and Pavelin, 2008; Cho and Patten, 2007); assessment of the quality of non-financial reporting (De Beelde and Tuybens, 2015; Lock and Seele, 2016); evaluation of the level of non-financial data credibility (Zheng and Ren, 2019); relevance of non-financial reporting data (Hassan et al., 2020); specific industrial features and their impact on quality of non-financial reporting (Fonseca, 2010). Summing up, the institutional aspects of non-financial reporting implementation are the subject of scientific studies. The general directions are the following:

- value of non-financial data and order of its application by stakeholders (Damayanti and Prayoga, 2021);
- quality assurance of entities' non-financial reporting (integrated reports, management reports, sustainability reporting, social reporting) (Sonnerfeldt and Aggestam, 2020; Lovinska et al., 2020);
- methodology of non-financial reporting preparation (Baret and Helfrich, 2019; Iefymenko et al., 2021);
- monitoring of the state of completeness of non-financial reporting regulation, industrial aspects and features for reporting (Kozhukhova et al., 2019; Vićentijević, 2019; Roszkowska et al., 2018; Maas and Sampers, 2020; Oliinyk et al., 2020; Calace, 2015);
- issues of e-format application of non-financial reporting preparation, XBRL (Barna et al., 2019; Beerbaum, 2017) and other directions.

Despite several current studies of non-financial reporting issues, the institutional and organizational aspects are not highlighted enough by researchers.

2. AIM OF THE RESEARCH

The work aims to explore the best practices of forming the institutional framework for non-financial reporting of enterprises, which governments of low-middle economy countries can successfully implement.

The object of research is international and national regulations and framework documents in the non-financial reporting of enterprises.

The value of the work is the creation of institutional preconditions for spreading the concept of corporate social responsibility among Ukrainian enterprises, which will increase the favourable business environment of the country and the efficiency of state resources management.

It is advisable to solve the following issues:

- to analyze the best world practice of non-financial reporting regulation;

- to explore the basic principles of formalizing the mechanism of collection and processing of non-financial reporting data of Ukrainian enterprises through the prism of international experience.

3. RESEARCH METHODOLOGY

The following approaches and methods of scientific analysis were used to solve scientific problems and achieve the ultimate goal of the study: institutional, systemic, empirical, structural-functional, comparative, retrospective, inductive, deductive, logical, analytical, formalization method and other methods.

The use of formalization as a method of researching socio-economic phenomena allows for formulating practical tasks related to the development and scientific substantiation of the collection and processing of non-financial reporting of enterprises. Furthermore, the appeal to formalization as a method of logic is due to its adaptability and the possibility of modification by the study's objectives, particularly the definition of logical structures and relationships in the system of non-financial reporting between enterprises and regulators.

The information base of the research is the scientific works of domestic and foreign scientists, normative legal acts of the Verkhovna Rada of Ukraine, resolutions and decisions of the Cabinet of Ministers of Ukraine, international normative documents in the field of non-financial reporting, and non-financial reporting of enterprises.

The research consists of the following steps: studying the world's best practices documents and initiatives in non-financial reporting (UN, EU); identifying the state of the Ukrainian non-financial reporting institute and directions for its further development.

4. FINDINGS

The use of formalization in research activities has several advantages; in particular, this method provides the opportunity for:

- fixation and transmission of different types of relationships between objects within the studied system;
- assessments of the nature of the relationship between the elements of the system;
- identification and formulation of the logical structure of the system.

Formalization of the data collection mechanism and processing of non-financial reports involves the implementation of several tasks:

- the study of approaches to the presentation of non-financial data of enterprises (formalization of non-financial reporting, i.e. analysis of types of non-financial reporting);
- the study of organizational measures in the area of entities' non-financial reporting;
- analysis of existing practices of collection and targeted use of reporting data.

The implementation of the above steps will form a database of objective data. These will form the basis for further developing the Ukrainian non-financial reporting model.

One of the forms of presenting data on the non-financial side of the enterprise is a management report. The adoption of Directive 2014/95/EU by the EU Parliament in 2014 meant that regulating the preparation of non-financial reporting of enterprises in a management report had begun. To support businesses in highlighting the impact of the relevant and transparent information on the economy, society and the environment, the EU Commission 2017 developed a Guide to Non-Financial Reporting.

The development of regulatory requirements for the content of the management report was preceded by numerous studies of the needs of the state and other stakeholders in non-financial information on the activities of companies (stakeholders' interest).

Directives 2013/34/EU and 2014/95/EU regulate the preparation of reports that ensure the disclosure of information by companies about their social responsibility. However, before the appearance of these documents, companies prepared such types of non-financial reports as "Social Report", "Corporate Social Responsibility Report", "The Progress Report", sustainability reporting, and others.

The regulation of the management and disclosure of non-financial information in the EU member states is constantly changing and improving. In particular, as noted in the recent

Communication on the European Green Course, the European Commission expects companies and financial institutions to strengthen their non-financial information. The primary users of such information are investors and civil society organizations who need a deeper understanding of the performance of financial and non-financial companies and their socio-environmental impact.

The process of adaptation of Ukrainian legislation to European practices is impossible without proper methodology. Scientific and analytical support of the adaptation process requires constant, consistent work for monitoring existing best practices' amendments.

In the context of the implementation of EU directive requirements in Ukraine, non-financial reporting of enterprises was introduced at the legislative level by making amendments to the following legal acts' provisions: the Law of Ukraine "On Accounting and Financial Reporting in Ukraine" from 16.07.1999 No 996-XIV, Resolution of the Cabinet of Ministers of Ukraine "On approval of the Procedure for submission of financial statements" from 28.02.2000 No 419; Order of the Ministry of Finance of Ukraine from 07.12.2018 No 982 "On approval of the Guidelines for the preparation of the management report". These documents define the conceptual basis for disclosing entities' non-financial information on their activities.

Following online consultations on corporate reporting in 2018 and online targeted consultations on climate-related reporting, the European Commission launched a new public consultation in May 2020 with the document "Fundamentals of Sustainable Investment and the Requirements of an Acceptable and Widely Applied Directive on Climate Reporting". This document reflects the general trend of various organizations and stakeholders calling for a new regulatory approach to non-financial reporting.

A new trend in the development of non-financial reporting of enterprises is to ensure the disclosure of quality information on climate issues.

Thus, in 2019, the European Commission, in Communication C (2019) 4490, amended Guideline 2017 C215/01 in terms of climate disclosure.

This document has been prepared under Article 2 of Directive 2014/95/EU to assist interested companies in disclosing relevant, useful, consistent and comparable non-financial information. The notification from the European Commission contains optional guidelines and does not create new reporting obligations for businesses.

According to Communication, companies and financial institutions must play a crucial role in transitioning to a low-carbon and climate-resilient economy. Companies and financial institutions need to understand better and address the risks of negative impacts on the climate that result from their business activities and the risks that climate change poses to their business. Weather disasters have caused record economic losses of 283 billion euros in 2017 and could affect up to 2/3 of Europe's population by 2100, up from 5 per cent today. Companies' better disclosure of climate-related information could help implement the Sendai Disaster Risk Reduction System for 2015-2030.

Without sufficient, reliable and comparable information on sustainability from the companies in which they invest, the financial sector cannot effectively direct capital to investments that help address the resilience crises facing humanity and identify and minimize the risks inherent in them.

In recent years, corporate disclosure of climate information has improved. However, there are still significant gaps, and joint efforts by the international professional community to improve the quality and comparability of information disclosure are needed to meet the needs of investors and other stakeholders.

In June 2017, the Working Group on Climate Disclosure (TCFD), established by the G20 Financial Stability Board, published recommendations to encourage financial institutions and non-financial companies to disclose information on climate risks and opportunities. The TCFD Recommendations are widely recognized as authoritative guidelines for providing financially relevant climate-related information, and the Commission encourages companies to apply them. In addition, several governments and financial regulators worldwide have expressed support for the recommendations and integrated them into their governance and policy frameworks. Examples are Australia, Canada, Hong Kong, Japan, Singapore and South Africa, and some EU Member States.

Communication from the European Commission C (2019) 4490 integrates TCFD recommendations and guides companies that comply with Directive 2014/95 / EU and TCFD recommendations.

According to Directive 2014/95/EU, the company is obliged to disclose information on environmental, social and employee issues, respect for human rights, as well as bribery and corruption to the extent that such information is necessary to understand the company's development, performance, position and the impact of its activities. Climate information can be considered a category of environmental issues.

According to the document under study, companies should consider using the proposed topics for disclosure if they decide that climate is a significant issue from the following perspectives: financial perspective or perspective of the materiality of environmental impact. As markets and public policies evolve in response to climate change, a company's positive and negative effects on climate will increasingly translate into opportunities and/or risks for financially significant activities. The materiality perspective of Directive 2014/95/EU covers both financial materiality and environmental and social materiality, while the TCFD considers only the issue of financial materiality.

It is advisable to carry out a permanent analysis of current changes and clarify EU policy requirements in their implementation in domestic legislation in accounting and reporting.

The adoption by the UN General Assembly on 25.09.2015 of Resolution A/RES/70/1 on the final document "Transforming our world: the 2030 Agenda for Sustainable Development" was a prerequisite for the spread of reporting by companies on their contribution to achieving the Sustainable Development Goals set out in this document. This is due primarily because the monitoring and analysis of goals and objectives are expected to be carried out using a set of global indicators. In addition, governments are empowered to develop their national hands to help track the progress of goals and objectives.

The form of presenting data on the contribution of enterprises to the achievement of the Sustainable Development Goals is the report on sustainable development. In this context, three main initiatives related to the sustainable development report process regulation should also be noted.

The first initiative is the most commonly used tool for non-financial reporting - the Global Reporting Standards for Sustainable Development, developed by the Global Reporting Initiative (GRI, 2020). The purpose of these standards is to assist organizations in understanding the content of disclosing the impact of their activities on the environment as comprehensively as possible. Standards represent a simple set of modules of standards of various directions: from universal to special.

The second comprehensive initiative was the development under the auspices of the Intergovernmental Working Group of Experts on International Accounting and Reporting Standards of the United Nations Conference on Trade and Development of the Guidance on core indicators for entity reporting on the contribution toward implementation of the Sustainable Development Goals (UNCTAD, 2019).

This document covers the primary levels of non-financial reporting (Fig. 1). In addition, it identifies an essential list of indicators that companies are encouraged to disclose in the Sustainability Report (or another form of non-financial reporting).

SUPPORT FOR GOVERNMENT

- in assessing the contribution of the private sector to the achievement of the CSB in accordance with indicator 12.6.1 (paragraph 9 of the Guide)

HELP FOR ENTITIES

- in determining the content of the non-financial report in terms of disclosure of the impact of the enterprise on the achievement of the CSB (paragraph 9 of the Guide)

Figure 1. Areas of application of the document's provisions "Guidance on core indicators for entity reporting on the contribution towards implementing the Sustainable Development Goals".

Source: [1].

The third current initiative in non-financial reporting is the work of the IASB in terms of preparatory work on the development of international standards for reporting on sustainable development. As part of this work, the IASB has published a Consultation Paper on Sustainable

¹ UNCTAD ISAR (2019). Guidance on core indicators for entity reporting on the contribution towards implementing the Sustainable Development Goals. Official website. URL: https://unctad.org/system/files/official-document/diae2019d1_en.pdf

Reporting, which aims to determine the feasibility of developing uniform standards for sustainable development reporting and identify the main problematic aspects of data disclosure.

In order to summarise the analysis of existing approaches to the formalization of data processing of non-financial statements, it is necessary to identify one of the main identified problems - limited or no quality control of non-financial reports.

An example of formalizing the collection of non-financial reporting data is the methodology for collecting and summarising data on sustainable development reports, developed by the United Nations Conference on Trade and Development.

This document contains the following main blocks: purpose and objectives, a list of minimum requirements for identifying reporting as a sustainable development report; content of reporting; format and sources of data collection. Sustainability reporting provides information relevant to understanding the long-term value of the company and its contribution to the sustainability of the global economy by taking into account the economic, environmental, social and managerial performance of the company and its impact. Sustainable development reporting provides information through quantitative data (key performance indicators) and qualitative information (description of the company's sustainable development strategy and reporting policy) as part of the company's reporting process.

The results of research presented by the UN on the system of collecting information indicate the need to develop a plan of collecting non-financial reporting of enterprises through:

- the creation of national depositories of non-financial reports of enterprises (reports on sustainable development);
- the involvement of stock exchanges requires the publication of a sustainable development report to listed companies, financial market regulators, and other supervisory authorities requiring companies to provide them with regular annual reports, which may also include information on sustainable development. Examples include the BM&F Bovespa's Corporate Sustainability Index (ISE) in Brazil or the Johannesburg Stock Exchange's Socially Responsible Investment Index in South Africa;
- support for sectorial initiatives (national, regional or international). Examples include sustainability reporting from companies represented in the Cement Sustainability Initiative or the International Petroleum Association;
- assigning data collection functions to national statistical offices.

A characteristic feature of building a database of non-financial reports is the ability to break down and aggregate in the following areas:

- the type of activity: it is recommended to apply the definition of economic sectors presented by the International Standard Industrial Classification of All Economic Activities (ISIC) or NACE, which is typical for Ukraine);
- types and scope of activities: separation of listed companies, public interest entities from non-listed companies and small and medium enterprises. It is recommended to use national classifications of companies by size.

Also, according to the UN methodology, the process of organizing data collection and processing according to indicator 12.6.1 involves the identification of entities responsible for data consolidation at the national, regional and global levels.

The study of existing approaches to the formation of databases of non-financial reporting allowed us to formulate the main features of their construction that need to be taken into account:

- definition at the legislative level of responsible entities for data collection and processing (representatives of the state executive power);
- a legislative stipulation of the obligation of enterprises and the procedure for publishing non-financial reports on the relevant information portal;
- taking into account the sectorial nature of enterprises in the formation of the methodological component of calculating aggregate indicators of the non-financial side of enterprises (impact on the economy, environment and society). This approach will ensure the multi-purpose use of aggregate data, in particular for critical users such as statistical services in conducting surveys to assess the country's progress towards the Sustainable Development Goals; other central executive bodies in the development of state sectorial policy;

- development of criteria for classifying information provided by enterprises as non-financial reporting (input features). An example of the latter is the methodology for collecting data on the indicator Sustainable Development Goals 12 "Responsible consumption and production" 12.6.1 "Number of companies publishing sustainability reports". In particular, this document proposes that companies publish information that meets the minimum disclosure requirements to consider the indicator (indicator 12.6.1). Thus, the methodology identifies the primary economic, environmental, social and management data.

The UN methodology includes a recommendation for creating an information platform for data collection and a typical model for organizing the aggregation and processing of sustainable development reports, as shown in Figure 2.

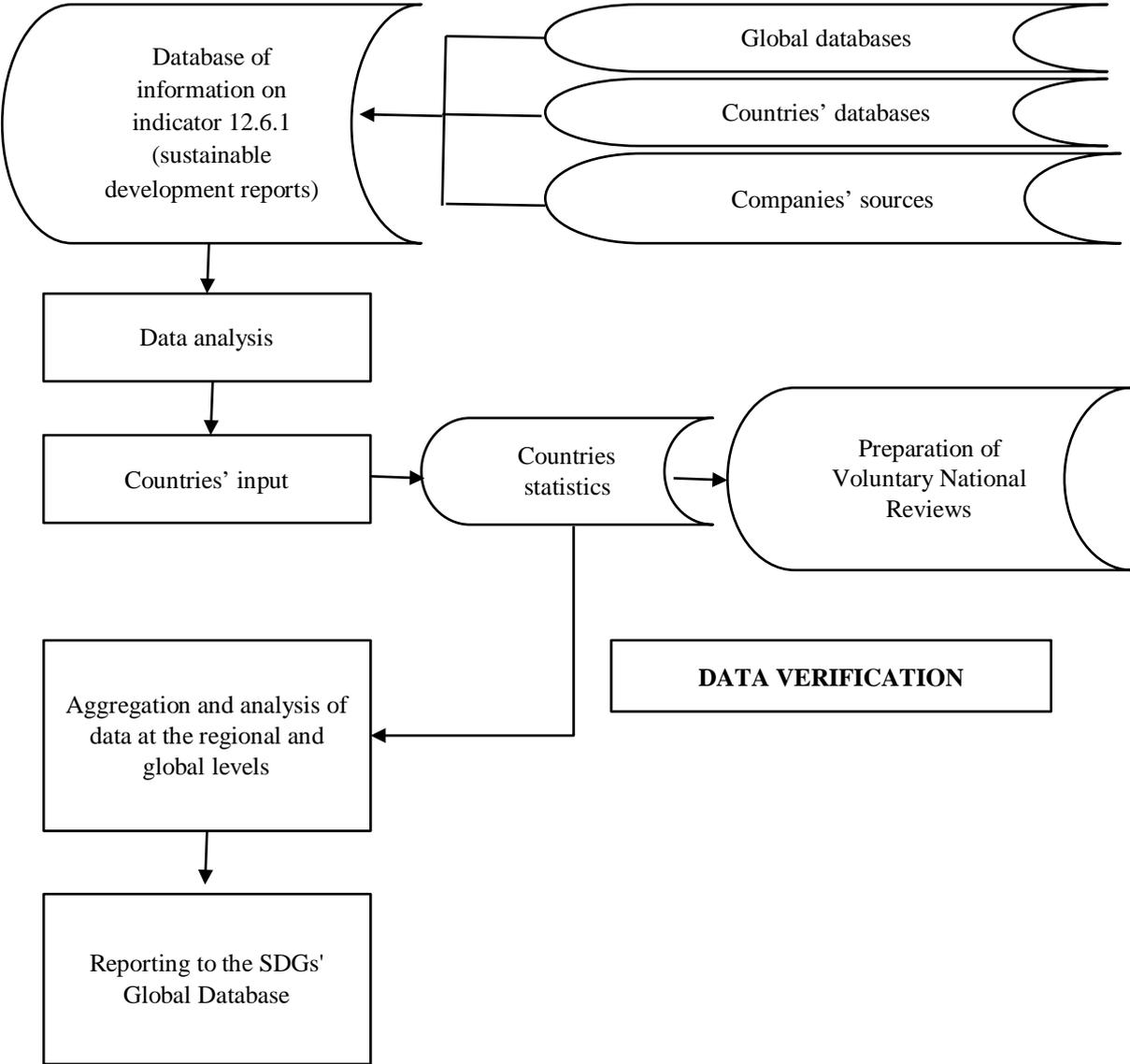


Figure 2. Model of data collection organization to the UN Global Information Depository. Source: [2].

Countries around the world can use a typical model as an analogue to build their model of non-financial reporting, in particular in terms of data collection and processing.

Ukraine is creating favourable conditions for implementing approaches to expand the CSR practices among Ukrainian entities that need alignment with European and UN practices.

² Methodology for SDG indicator 12.6.1 Proposal from the Custodian Agencies. https://environmentlive.unep.org/media/docs/projects/draft_proposal_methodology_12_6_1_may_2019.pdf

At the same time, the next stage in the formation of entities' non-financial reporting institute in Ukraine is the development of its regulatory and organizational framework through the following measures:

- determination of administrative procedures (collection, processing and accumulation of entities' non-financial reporting);
- formation of the effective model of interaction between the subjects of non-financial reporting in Ukraine;
- establishing directions for the use of non-financial reporting data as an essential source of information for consolidation of information to form macroeconomic indicators of socio-economic development of the country;
- development of the methodology to ensure the quality of entities' non-financial reporting.

5. CONCLUSION

The study of existing best practices in collecting and processing non-financial reporting data allowed us to identify the need to create a national platform (database) for the non-financial reporting of enterprises.

The analysis of modern approaches to the formation of databases of non-financial reporting allowed us to formulate the main features of their construction that need to be considered:

- definition at the legislative level of responsible entities for data collection and processing (representatives of the state executive power);
- a legislative stipulation of the obligation of enterprises and the procedure for publishing non-financial reports on the relevant information portal;
- taking into account the sectorial nature of enterprises in the formation of the methodological component of calculating aggregate indicators of the non-financial side of enterprises (impact on the economy, environment and society).

This approach will:

- ensure the multi-purpose use of aggregate data, in particular for critical users such as statistical services in conducting surveys to assess the country's progress towards the Sustainable Development Goals; other central executive bodies in the development of state sectorial policy;
- develop criteria for classifying information submitted by enterprises as non-financial reporting (input features).

Governments in low-middle economies can use the experience gained to build a sustainable infrastructure for reporting on sustainable development.

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