The Evolution of Non-Financial Disclosure in a European Perspective

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CSR PAPER 14.2007

DECEMBER 2007

CSRM – Corporate Social Responsibility and Sustainable Management

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  Milan, June 22-23, 2006
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  Milan, June 14-15 , 2007
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The Evolution of Non-Financial Disclosure in a European Perspective

Summary

The propensity to disclose information about corporate non-financial performance has grown across Europe as a result both of Regulation no. 1606/2002 and higher market sensitivity to enterprises adopting socially responsible policies. This study starts with a through examination of the theoretical literature on the subject. In the second part of the study, moving from the European Commission guidelines on the subject, a survey has been made so to group European countries in three categories with respect to their actual degree of compliance, with both the updating process required by EU directives and other regulations concerning mandatory non-financial disclosure at national level, if any. Starting from the results of the empirical evidence, looking at investors as primary category of stakeholders and considering listed company, a statistical analysis has been conducted in order to verify whether there is a correlation between the development of local financial markets and the position assumed by regulatory agencies on non-financial information.

Keywords: Non Financial Reporting, Mandatory and Voluntary Non Financial Disclosure, European Financial Market

JEL classification: M

This study is the result of the joint effort of the co-authors. In particular, paragraphs titled Theoretical background, Empirical research in Europe, Results from Eastern Europe, Mandatory or Voluntary Disclosure? Advantages and Disadvantages are related to Francesca Manes Rossi, while the others are related to Alessandra Allini.

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Theoretical background

Corporate external disclosure is certainly one of the main tools for value creation and diffusion, in so far as it considerably affects corporate ability to attract resources and gain consensus (Eccles & Lupone 2000). In the past, the disclosure was correlated with accounting data based on the measure of income and the related invested capital. However, current dramatic changes have determined increased complexity in the socio-economic scenarios where companies operate today. This has revolutionized corporate behaviour, introducing constant interaction between enterprises and their investors. As a result, enterprises today can no longer afford to define their prospective conditions of economic equilibrium neglecting their social equilibrium conditions (Ansoff 1988, Coda 1988, Carroll 1999).

Scholars started taking the social aspect into due consideration well long ago, pointing out that companies should be accountable not only to those parties having a direct stake in them, but also to the community (Ferrero 1968, Onida 1971).

Timely knowledge of the expectations of the various parties interacting with the company, and appropriate incorporation of the expectations into the company's strategic objectives will unquestionably add to confidence, and this in turn will positively, though intangibly, contribute to the business's long-term success (Beauchamp & Bowie 2001, Nagel 2001). Several empirical investigations at international level have been carried out to verify the correlation between social performance and profitability (Aupperle et al. 1985, Ullman 1985, Wood 1991, Wright & Ferris 1997, Wagner 2001, Margolis & Walsh 2001) although the existence of a *direct* link between the two aspects is not easily demonstrable, as recently shown by Schuler & Cording (2006). According to Griffin & Mahon (1997) as well as Waddock & Graves (1997) discrepancy may be due both to the types of social parameters used to measure this relationship, and a set of other variables that affect the interaction between social and economic performance but are often neglected in empirical research. In any case, the specific relation mentioned will not be discussed in this study.

In this dynamic and complex scenario, it might be helpful to reconsider the function of the financial statement (Cavalieri 1981, Catturi 1997). This statement, as traditionally conceived of, fails to meet today's ever growing and elaborate information demand (Potito 2002).

Current trends show a wider typology of data required - moving from social disclosure to non-financial one - and a proliferation of tools relevant to voluntary disclosure in order to allow for more accurate assessment of corporate performance.

Information disclosure on a voluntary basis can be implemented by adopting either of two different approaches: a forward-looking financial approach and a soft non-financial approach (Quagli & Teodori 2005). The former is particularly advisable in the case of medium and large sized businesses (usually listed) where investors have a vested interest in reducing the information gap, in terms of time, between investment and cash return. As a result, disclosure of information about corporate strategy, plans/programmes, possible risks involved in corporate decisions is requested and appreciated by the market itself (Higson 2004).

As to the latter approach, on the other hand, it is undeniable that enterprise success is influenced, among other things, by consensus and reputation, which thus will represent a strong point in strategic decisions (Roy & Vezina 2001, Swift 2001, Godfrey 2005) in so far as they add to the brand value and improve relations with the stakeholders.

Belkaoui and Karpik (1989) carried out a research to verify the existence of a correlation between the adoption of external reporting, particularly non-financial one, and four types of variables, i.e. social performance, monitoring costs, political visibility and, finally, financial performance.

Focusing on listed companies and considering investors as priority stakeholders, voluntary disclosure would be added to the mandatory one, thus reducing information asymmetry between companies and investors. In this way, the cost of capital would be decreased, with positive effects on share liquidity (Bushee & Noe 1999, Healy & Palepu 2001). Eccles et al. (2001) point out that wider voluntary disclosure could attract more investors interested in long term results. The same disclosure could also result in a higher number of financial analysts involved. Moreover, considering that analysts could have access to a wider range of data (voluntarily disclosed) they would be in a position to work out more accurate assessments, thus supporting market efficiency and vitality (Lang & Ludholm 1996); meanwhile, this context would bring about a self-fostering circuit where, by asking for more data, financial analysts would promote further voluntary disclosure.

However, it has been observed that excess voluntary disclosure may generate the opposite effect, namely a reduction in asymmetric information could create a levelling-off of disclosure, with consequent decreased interest by policy makers. These operators, in fact, take advantage of their specific knowledge of the company; therefore, if they lose their competitive advantage, the number of stock exchanged could be decreased as a result. (Diamond & Verrecchia 1991).

Over the last decade speculation on this subject has resulted in a great deal of concrete applications. Many international initiatives by professional associations and institutions (such as, for example AICPA, FASB and CICA) have been recorded, supporting additional statements to be drawn up besides traditional financial reporting in order to allow outside users to work out reliable assessments of both the predictable evolution of business management, and the key factors in the process of value creation. The need for more comprehensive information about corporate performance has been recently taken into account by Stock Exchange Watchdog Bodies, who have requested of listed companies that additional information (including non-financial one) be disclosed as a general rule, on the grounds that it might count as a risk determinant.

Recent legislation by the European Commission reflects the mentioned scenario. As a result of the process of accounting harmonization brought about by Regulation no.1606/2002, the Commission has reconsidered the contents of its Accounting Directives (*Modernisation of the Accounting Directives*). One of the most significant amendments concerns the minimum content of the Management Report, which, in its updated version, allows for disclosure of information also of "*non-economic or financial nature*". Each Member State, however, would be responsible for drafting the specific procedures to incorporate the new requirement into national legislation.

With reference to the process of accounting harmonization involving the mandatory use of IAS/IFRS, the IASB project certainly deserves mentioning. In collaboration with some international standard setters, the IASB project has released a discussion paper entitled "*Management Commentary*" (MC) with the purpose of working out an archetype, similar to a Management Report, for the disclosure of corporate information, particularly qualitative.

The primary objective of the mentioned project is actually to investigate current and prospective corporate performance in order to provide "*other user oriented information*" usually missing in a financial statement.

IASB clarifies that, by releasing this statement**,** companies would be contributing to the market additional information particularly valuable when taking investment decisions. It thus follows that the main recipients of the information in question are essentially investors. However, considering the great variety of cultural frameworks of reference, what sort of investor is to be addressed? The Anglo-Saxon tradition typically equates an investor with a stakeholder. By contrast, in some continental countries, an investor is usually an entrepreneur. Taking the

argument to extremes, and based on the assumption that an enterprise is, among other things, a system of relations (Freeman & Evans 1990, Donaldson & Preston 1995) then any stakeholder somehow sharing in the enterprise risk might be referred to by the term "investor".
It ensues that, in corporate strategy, when focusing on the variables which might condition enterprise success/risk, consideration of the expectations of the various stakeholders – such as customers, suppliers, even the local community – will undeniably affect business value/risk in particularly in certain enterprises, i.e. the large-sized ones operating in sensitive productive sectors (Rusconi 2006, Zadek & Radovich 2006).

Empirical Research in Europe: Sample and Method

Two driving forces are inducing enterprises across Europe to disclose information about their non-financial performance, beside their usual financial ones:

- an *institutional drive*, which includes:

a) the European Commission's recent view of non-financial reporting can be traced to directive 2003/51/EC on annual corporate accounts, which for the first time offered enterprises the opportunity to publish non-financial data in addition to the financial requirements. Indeed, the March 2006 Communication confirmed this approach by encouraging enterprises – especially large ones – to make information on their CSR strategies voluntarily available to all stakeholders;
b) demands by various local financial markets supervisory authorities;
c) the IASB proposal, based on its "Management Commentary" project;
d) local legislation concerning suggested on mandatory non-financial disclosure.

- a *voluntary drive*, which encompasses the various proposals put forward by the bodies responsible for drafting national standards, or by qualified national or international study groups that have proposed reference models or defined the minimum content for reports concerning corporate non-financial disclosure.

Not all European countries show the same sensitivity for, and attitude to accounting matters. Discrepancies have already emerged concerning the financial reporting. The existence of various forms of "capitalism", each modelling the economic structure of a certain country, turns out to be particularly significant when the role played by the various stakeholders is taken into account.
Albert (1991) for example, differentiates neo-American capitalism, typical of the Anglo-Saxon countries where enterprise is considered as an alternative investment opportunity, from Rhenish capitalism, typical of Continental Europe where enterprise is regarded as a system in which stock capital is concentrated in the hands of few subjects (usually banks, or other institutional investors). As a result, in the latter case, stakeholders interests will be necessarily intended in a more inclusive and comprehensive sense, relevant to the all subjects involved. Consequently, the financial statement will have to address the demands of all stakeholders that are, directly or indirectly, involved in corporate management, and not exclusively the needs of potential investors, so to relate enterprise positively with the environment.
Practically, the extent to which reporting is being taken into serious consideration is revealed by a close survey of the activities of European Member States. In fact, governmental reporting and disclosure requirements on non-financial information do already exist in several European countries.
Government Ministries from each Member State are becoming more active in reporting on the non-financial performance of the major companies in their countries, particularly after the recent European legislation in its updated version.
On the subject, some Italian scholars (Quagli & Teodori 2005) make a distinction amongst *required*, *voluntary* and *mandatory* information, considering the different degrees of discretion

(about format, way of explanation and contents) adopted by a company when disclosing data. According to the Authors, the required information would result from specific requests and high pressure by investors and other professional operators, demands that enterprises will have to meet under certain circumstances.

Disclosure could be classified as follows:

- mandatory;
- required:
  discretional in content, format and communication conditions;
  discretional in content and format, but regulated in communication conditions;
  discretional in content but regulated in format and communication conditions;
- voluntary.

In this respect, and considering this new legislative development, it would be helpful to have a preliminary glance at the course taken by each of the various European countries – either *voluntary* or *mandatory* non-financial disclosure in annual accounts (or annual reports) – considering in particular the following soft topics:

- *Employment*
- *Business Processes & Policies Environmental Impact*
- *Business Policies Social Impact*
- *Customer Satisfaction*
- *Suppliers*
- *Identity (Mission/Vision and Ownership Structure).*

European countries must be examined based on whether non-financial disclosure has been implemented on a voluntary basis, or as a result of institutional pressure (either required or mandatory). The purpose of this part of the research is to sketch out an initial hypothesis about the role that the regulatory systems, the degree of complexity and the structure of local financial markets might have played in the disclosure process of all elements related to non-financial disclosure, as a result of the commitment of enterprises in Corporate Social Responsibility (CSR).

Starting from this assumption, the research asked all European national standards setters the following questions:

- Did any local law requiring mandatory non-financial data in the annual report already exist?
- Was national law amended after the modernisation process of Accounting Directives so as to include "non-financial information" in the annual account?
- If so, what type of non-financial data became mandatory?
- Are there any national standard setters adopting standards on voluntary non-financial disclosure?
- If so, what type of non-financial information is advised reporting?
- Whenever a response was received, there was a direct consultation of local web sites.

In relation to this, national organisations were also consulted, to check whether they had produced any specific guidelines or documents to define the contents of "non-financial information" included in the annual report.

Some countries provided no information at all, and were considered as cases lacking regulation (both voluntary and mandatory).

Results

The encouragement for the process on non-financial reporting from institutions, financial markets, academic and professional groups put in evidence that current disclosure have not “the same fate as the earlier 1970’s initiatives” (Owen 2003).
Three phases can be identified from a theoretical point of view:
- the first phase (1970s-1980s) when social accounting rapidly became a new fashion, partly because of public pressure; therefore, a number of companies voluntarily joined one or another form of the social reporting movement (Hoffmann 2001). The first country to focus attention to social disclosure was Germany; then, other western European countries followed the same approach (Preston et al. 1978: 40). Problems began to arise in the mid-1980s, when the opportunity to regulate such type of report, seen as the only way to get a large number of companies to prepare and publish it, clearly emerged. Nevertheless, the only one country that actually introduced a specific law requiring corporate social reporting was France, in 1977;
- the second phase (from the mid-1980s to the late 1990s) when attention on social reporting decreased as a result of containment of pressure from established groups, including Unions (Hoffmann 2001: 214);
- the third phase (the late 1990s to the present) when the experience of the 1990s has shown that radical free-market strategies have failed to solve social problems and that merely maximizing shareholder value has not automatically enhanced the welfare of society. It has become evident that the development of the information system ought to include all data on non- financial performance. The EU became aware of this and, after several recommendations (such as The Green Book) issued the directive 2003/51/EC in which to the extent necessary for an understanding of the company's development, performance or position, the analysis shall include both financial and, where appropriate, non-financial key performance indicators relevant to the particular business, including information relating to environmental and employee matters. The content of the updated Directive refers both to listed and unlisted companies. However, the requirement is particularly significant for companies that operate on financial market and have to disclose all relevant performance, not only the financial one, to investors and other stakeholders.

Results from Western Europe

The empirical research has been conducted moving from western to eastern European countries, just geographically determined, and considering the evolution of non-financial disclosure.

In the *United Kingdom* the innovation process took place in 1998, when a fundamental review of British Company Law was undertaken. The review recommended that companies of significant economic size should be required to prepare and publish an Operating and Financial Review (OFR) as part of their annual report and account. The first step was the publication by the Government of a White Paper, “Modernising Company Law”, in July 2002, which contained some illustrative clauses on the OFR to aid discussion.
The OFR would provide shareholders with better and more relevant information on the business, its past performance and its future prospects; the intention is not to replace other reports already prepared by companies (like CSR reporting), but to provide a narrative report setting out the company’s business objectives, its strategy for achieving them and the risks and uncertainties that might affect their achievement, as well as other information, including data on employees, environment, social and community issues.
In October 2006 the new Company Act was passed, requiring the Directors Report to give information about the development and performance of the company (except for small companies)[1]. The Company Act will be fully enforced by October 2008, but this part, as well as others concerning communication, have been in force since January 2007.

In the United Kingdom companies are very sensitive to giving non-financial information. Also, the Government itself has specially set up the Ministry of Corporate Social Responsibility to address this issue, and several guidelines to improve companies social responsibility have been enforced.
In *Ireland* too there is widespread public awareness that a company's CSR commitment is important when making purchase decisions.
In *Malta* the Companies Act, issued in 1995 and updated several times on UK model, has required companies (not only the listed ones) to comply with IFRS since 2005. As a consequence, information about environmental impact and company's policies adopted, have to be given in the Directors Report.

In *Portugal* companies with 100 or more employees are required by law to issue a social report every year since 1985. This report provides information on human resources management, effectiveness of social investment, and actions to improve employees' quality of life. The Government project tries to push other companies too (with fewer than 100 employees) to provide the same information, according to the same model, by 2009.
In the annual account, all companies have to disclose information about environmental impact and all provisions related to this policy. Disclosing information about ownership structure has been compulsory since 1989. The *Directricez contabilistica 29,* issued in June 2002 and enforced in January 2003, obliged companies to disclose all provisions and costs related to environmental factors in the notes (*Anexo*) and in the Annual Relation (*Relatorio de gestão*). There is no further indication concerning the process of Directive Modernisation.

In *Spain* the Resolution issued on March 25th, 2005 in compliance with European Commission Recommendation, states that organizations are obliged to include environmental assets, provisions, investments and expenses in their financial statements. Since 2004 most of the companies listed on the Stock Exchange have published information on their CSR policies, mainly based on the GRI model. To update the accounting law *(Plan General de Contabilidad*) in February 2007 some changes were designed (but not approved as yet) which request information concerning costs paid for environmental protection as well as provisions. Certain sectors (for example Energy) have voluntarily started to set up standards for the inclusion of environmental data in financial reporting.

In *France* mandatory social reporting was introduced as early as 1977. In particular, Decree no. 1354 outlined 134 measures and indicators to be reported in the so-called "*bilan social*" (Pulejo 1996). French law requires a report "composed of a lengthy list of indicators open to ulterior statistical treatments and multiple interpretations" (Capron 2000) and its scope is quite narrow, covering only employees, with chapters on payment, health and safety, working conditions and so on.
In 1999, a proposal was made by the French Economic and Social Council to update the indicators and in 2001 the New Economic Regulations modernizing French company law framework[2] were adopted by the French Parliament. However, the law was silent about the perimeters (geographical or otherwise) of the reporting requirements and did not specify whether the regulation affected also the subsidiaries, business partners, joint ventures and so on.
As for voluntary disclosure, there have been several initiatives (such as the one by AFNOR - Association Française de Normalisation - SD 2100) issuing local guidelines, including recommendations to help companies integrate and implement sustainable development objectives in their overall strategies and management.

In *Belgium* companies employing more than 20 wage earners have been required to include a *bilan social* concerning the nature and the evolution of employment in their annual report since 1995. The document must be submitted to the National Bank of Belgium, which is responsible for the collection and distribution of the annual accounts based on Belgian enterprises'social reports. There are two versions: a full one, to be prepared by large companies, and an abbreviated on, to be drawn up by medium-sized entities[3].

In the *Netherlands* a voluntary code to improve social disclosure was adopted as early as 1993. Since 1997 companies have been legally obliged to disclose annual environmental performance information: the NIVRA introduced the mandatory reporting system in order to increase companies' awareness of and responsibility for the environmental effects of their activities. The Dutch mandatory reporting regime can be regarded as a success, as it has significantly increased the environmental awareness and the insight into the environmental performance of companies, so that the Netherlands are now the fourth country in Europe to produce information according to the corporate social responsibility standards (Scott 2006)[4].

In *Luxembourg* the generally accepted accounting principles comply with the 4th EU Directive on the annual account of companies. However, Law of December 19th, 2002 introduced an optional regime under which companies may, in special cases, opt to present their statutory annual accounts under a different framework (e.g. IFRS). On Jan 1st 2006, the national law was changed in order to comply with the updated Directive.
Other factors have led Luxembourg to consider CSR. First, many multinationals based in the country were already embracing CSR. Then, thanks to the unique nature of the Luxembourgish marketplace both multinationals and SMEs operate and interact side by side. This has created a positive environment for social responsibility awareness and has increased the effect of peer pressure on enterprises. As a consequence, since 2003 the Minister of Labour and Employment has been actively promoting CSR on a national basis. The first significant manifestation of this activity was the development of the '*Charte portant sur le dévelopment durable*' in 2003 by the Union des Entreprises Luxembourgeoises (which includes large corporations and SMEs), in response to the 'Green Book' and sustainable development issues.

In *Italy* there is a high degree of consciousness about companies non-financial commitment, both from academics and standard setters.
On a voluntary basis, in 1998 GBS (*Gruppo Bilancio Sociale*) issued a standard to define social report models both for the public and private sector. The Italian standard setter (CNDC) adopted a document to endorse a "sustainability report" according to the GRI's model.
The Italian Government itself has concretely supported this consciousness. In fact, during its EU presidency semester, Italy promoted the definition of an audit standard on CSR.
On a mandatory level, no specific legislation requiring non-financial disclosure in the annual account exists; however, various institutional bodies have adopted a number of different reports on social aspects. For example, Consob (the public authority responsible for regulating the Italian Stock Exchange) requires all companies promoting social activities to disclose soft data to the financial market.
After the modernisation of European accounting directives, the Government adopted Decree no. 32, 2nd February 2007, which requires to include in the Management Report, where appropriate, non-financial information relating to environmental and employee matters.

Results from Eastern Europe

In *Sweden* as early as 1999 some companies have been required to include information on the environmental impact in their annual financial accounts. The Institute FAR SRS[5] requires that sustainability reporting should be included in the agendas of financial analysts, accountants and other finance-related groups and the Swedish Financial Analysts Association's recommendation on sustainability reporting within annual reports is another driving force for it. The Accounting Modernisation Directive 2003/51/EC has been implemented in the Swedish Annual Accounts

Act. The new version provides that non-financial information should be reported in the audited Directors' Report of listed companies by the financial years ending after April 2006.
In January 2006 the Swedish Environmental Protection Agency (EPA) published a report on "*The financial market, the environment and reporting*" concerning the financial market's need for sustainability data. This report addresses the requirements of financial analysts regarding sustainability data and concluded that their needs were not met by today's voluntary reporting, because the reports are lacking information as to the manner in which sustainability matters influence the company's opportunities and risk management. The financial market expects to receive its information in the form of audited financial reports from a clearly defined entity. The Accounting Modernisation Directive being implemented in the Swedish Annual Accounts Act may help companies to focus their reporting on non-financial risks.

In *Finland*, the GRI is the most common guidance used by Finnish companies. This country also introduced elements of the Commission's recommendations (such as Recommendation of May 30th, 2001, on the recognition, measurement and disclosure of environmental data) related to annual accounts and annual reports of companies (2001/453/EC) into its legislation. In this way, requirements for disclosure in annual reports have been integrated into national accounting standards. On a mandatory level, only after the European evolution has the New Accounting Act (enforced in 2005) required companies to disclose environmental and HR issues in their annual accounts.

In *Denmark* national institutions are sensitive to non-financial reporting. With the Annual Accounts Act 2001, the Danish Government has been "pro-sustainability", urging companies (whether listed or not) to produce an annual report focusing particularly on environmental aspects and on intellectual capital, prior to the EU modernisation directive.
The Ministry of Social Affairs released a set of guidelines for social reporting, while the Ministry of Employment has contributed to the production of social reporting for small- and medium-sized enterprises (SMEs). The Danish Financial Statement Act requires listed companies and state owned public limited companies to report on intellectual capital resources and environmental aspects in a Management Report, whenever it is material to provide an accurate view of the company's financial status. All listed companies have to report on relevant non-financial information issues in their annual report.

In *Germany* there is an old-established tradition of social reporting. For the 1971-1972 business year STEAG, a major utility company, published a social account which acted as a reference in the subsequent debate about corporate social reporting. Soon after many companies imitated the STEAG type of social accounting. A few years later, the working group on "*Social Accounting Practice*" (AKSP 1977) which over thirty leading German companies belonged to, recommended applying an integrated multifaceted approach consisting of three parts: the "*social report*" the "*value-added accounts*" and the "*societal impact account*". Some companies fully applied the three parts of the AKSP model, whereas others started with a limited approach, preparing only one of them.
More recently, '*Bilanzkontrollgesetz*' (BilKoG) and the *'Bilanzrechtsreformgesetz'* (BilReG) led German financial reporting towards IAS/IFRS requiring German listed companies to report on non-financial performance indicators since January 1st, 2005. CSR in Germany is growing in close correlation with the national economic and social framework and is considered a fundamental part of German highly regulated and institutionalised industrial relations system. On a voluntary basis, there is also a model prepared by the study group *Social Bilan Praxis.*

In *Austria* there are no mandatory requirements other than the compliance with the EU Modernisation Directive. As a matter of fact, the Government is looking for guidelines for reporting on CSR; however, in some Regions, local requirements on the matter do exist.

Meanwhile, national guidelines on sustainability report have already been adopted, and the number of companies producing such reports is steadily increasing. The reports are generally prepared according to GRI guidelines (more than 50% of all reports are from SMEs and non-industrial organisations).

In *Greece* and in *Cyprus* no indications concerning either mandatory or voluntary non-financial reporting have been found; only in Greece there are some guidelines regarding insurance and banking sectors.

In *Poland* the Polish Accounting Act, issued in 1994 and amended in 2002, requires that the annual report should include financial and non-financial indicators, together with the information relating to environmental and employment matters. Additional explanations should be further included in the financial statements, in case they are material to interpret the entity's position. A research conducted by the World Bank in 2005 pointed out that Poland is still at the early stages of adopting these approaches compared to other EU Member States. On a voluntary bases, in 2000 Responsible Business Forum was founded to provide in-depth focus on the concept of CSR. According to some empirical researches, only 20% of big companies comply with industrial, national and/or international regulations on environmental standards, 18% of listed companies disclose employee development/employee benefit policies, and 16% disclose information on community involvement programmes or sponsorships.

In the *Slovak Republic* the process of compliance with the European Directive was so rapid that it was concluded as early as 2004 and the new law was enforced on January 1st, 2005. As a rule, the financial statement is to be prepared in accordance with this Act (no. 561/2004 Coll., update 26.5.2005), but companies may also provide a report following IAS or other recognised accounting principles. In the notes to the financial statements the company may provide information on events "*which have not been presented in other parts of the financial statements as of the balance sheet date, but whose effects materially influence the view of the accounting entity's financial position*".

In *Hungary*, no mandatory requirements or local standard setters defining guidelines for voluntary social reporting existed, but upon entry into the EU, the new Hungarian Act Company has required that "*business report shall contain (…) where necessary, all non-financial indicators of key importance which are of the essence in terms of the company's business operations*".

In *Estonia*, the Law of Accounting (RT I 2002, 102, 600) does not require any particular soft information. However, on a voluntary basis there is a Guideline on Environmental Investment Assessment (EIA), prepared by a local non-profit organisation, as well as models of code of conduct, mostly in a verbal form. CSR reports and relevant auditing do not exist in Estonia as yet, neither are any consulting advisory services being offered to firms. Finally, no official information is available on SA 8000 standardization.

In the *Czech Republic*, the Czech Accounting Standard (CAS) was established by the Accounting Act adopted in 1991 and amended fourteen times since then. Despite this, no reference concerning the provision of non-financial information to be submitted in the annual report is given.

Also in *Romania* mandatory reporting of CSR performance is not required and verification of CSR performance or expenditure does not occur. Some companies (especially multinationals) have made tentative attempts to set up CSR programmes, but this was done only within the limits of the Romanian Sponsorship Law and as functional to marketing or advertising investment.

Conversely, some Eastern countries, such as *Bulgaria, Latvia, Lithuania*, or *Slovenia* have adopted no regulations, references, guidelines or local standards on social disclosure (either mandatory or voluntary) at all as yet.
A survey made by PFS programme[6] suggests that firms in Bulgaria, the Czech Republic and Romania are mainly focused on the internal aspects of their operations and indicates a lack of positive signals or incentives by governments. In very few cases, such as the Slovene and Czech financial markets, information about employee benefits and compliance with environmental standards are part of the companies annual report on a voluntary basis.

First considerations about the state of the art on non-financial information in Europe

An overview of the above, allowed to divide European Countries in three theoretical areas, as shown in the figure below.

(Insert Figure 1 here)

In a number of Member States non-financial reporting is already mandatory, although the content of local law is quite vague. Consequently many standard setters issue specific guidelines to support more accurate reporting. This group, coloured in *red*, which shows a *proactive* attitude, includes Belgium, Denmark, France, Ireland, Malta, the Netherlands, Portugal, and the United Kingdom.
Conversely, in Austria, Finland, Germany, Hungary, Italy, Luxembourg, Poland, Slovakia, Spain, and Sweden, it was only the modernisation process of accounting directives that induced national standard setters to extend the mandatory corporate information, with soft data concerning mainly environmental and HR matters. This second group, coloured in *green,* shows a *compliance* attitude. But, while in Finland, Italy, Germany and Sweden companies adopted voluntary social report well before the evolution of the law, sometimes even anticipating local standard setters' indications (as in the case of Germany and Sweden), in the remaining countries this process occurred only as a result of compliance with European regulation.
Finally, in the other nine countries, coloured in *yellow*, classified as *unrelated* (Bulgaria, Cyprus, the Czech Republic, Estonia, Greece, Latvia, Lithuania, Slovenia, Romania) there is no indication concerning any mandatory or voluntary requirements[7].
The data collected highlight that the most attention is devoted to information related to employees and environment, while the number of countries disclosing information about the other four factors (*social impact, customer satisfaction, suppliers* and *identity*) is very low.

(Insert Figure 2 here)

In particular, it has to be noticed that serveral countries where information is required by law are either related to the United Kingdom or have a strong consciousness on social/environmental aspects. Regarding countries related to the UK, generally speaking, institutions have pressured into wide disclosure in order to provide investors with all elements necessary to compare different investments. Their economic, social and political contexts seem to consider this as absolutely essential. Meanwhile, Portugal, in the last 15 years, has shown a strong bent to comply with international standards on accounting matters, as a passport to economic development.
In other countries, such as Germany and Italy, the context is sensitive to non-financial disclosure, but regulatory agencies focus mainly on employment and environmental matters.
It must be observed that *voluntary* guidelines tend to include all aspects of non-financial information, sometimes supporting the production of reporting with detailed indications.

The European context mainly highlights two aspects (environmental and Human Resources) to be disclosed to financial market. However, the soft variables that may affect business risk are more and can regard different matters (such as customer satisfaction, chain of suppliers, local community's relationships).
The law provisions concerning the indication of such information in the *annual account* do not determine a process of "socialization" of the same annual account and inevitably do not satisfy the demand for social data, because the nature and the content are not necessarily comprehensive.
Lang e Ludholm (1996) say that the extent of the disclosure is conditioned both to law and other variables, such as the firm's size and performance. But the gap between voluntary and mandatory disclosure is not so simple to define, also because the concept itself of "voluntary disclosure" can change in time and from place to place. For instance, the Notes to the financial statement are meant to give indications concerning the number of employees but, in practice, some companies use them to disclose further data, such as the turnover, the composition or the training expenditures. In this case it is not easy to specify if these data are mandatory, required or voluntary.
Based on the above considerations and the first results of the research, it is possible to group countries together according to the behaviour adopted by local governments (voluntary, required, mandatory), with specific reference to each main area of non-financial disclosure, as shown in the figure below:

(Insert Figure 3 here)

Mandatory or Voluntary Disclosure? Advantages and Disadvantages

The data highlight that non-financial reporting mainly results from government indications (as a sum of *required* and *mandatory* information) but there are also other drivers that may influence the evolution of non-financial disclosure, such as "*business and society*" (Moon 2004:17).
In particular, the capitalism model could influence the sensitivity to non-financial matters; meanwhile, referring to European situation, it has to be noted that not all countries fit either in the *Renish* or in the *Neo-American* models. As a matter of fact, Eastern countries have recently joint the EU so their capitalism model can not be gathered in the models above. In those countries, "*the development of new democratic capitalist system is necessarily going to be slow and tentative, especially in the absence of the sort of social capital predicated upon a well established civl society and long-standing habits of business responsibility*."(Matten & Moon, 2004: 20)
Several researches have been conducted in order to assess whether or not to standardize this type of disclosure, but there is no unanimous agreement on this. Freedman and Stagliano (2002:94) argue that "*mandated environmental disclosure may be used by stakeholders to aid in the assessment of a company's environmental performance*". Lev and Zarowin (1999) notes that disclosure regulation is aimed at mitigating the adverse effects resulting from such market inequity. The question is to what extent the law should mandate the disclosure to investors. Although the advantage of mandated non-financial disclosures has not been accepted universally by scholars (Tinker et al. 1991, Buhr & Freedman 1997) it is possible to define the following arguments to support it:

Credibility: the adoption of recognised rules regulating this type of reporting and the identification of generally accepted guidelines should enhance the credibility of the report provided to the stakeholders and particularly to the financial market.
Comparability: the standardisation of non-financial disclosure assists investors to properly assess corporate performance and company's risk in time and space by allowing them to

compare investment decisions more easily and by the same criteria (Adams 2002). Legally required corporate soft disclosure also promotes equal treatment of investors, making sure that each of them can gain full access to information relevant for their choice of investment.

Completeness: non-financial voluntary disclosure often fails to address certain issues, such as environmental matters. By contrast, a law requirement can prevent enterprises from selectively disclosing only positive data while deliberately neglecting any information that could negatively influence market perceptions, or future earnings and potential cash flow.

Market failure and free rider problem: as demonstrated, socially responsible corporate behaviour allowed to achieve better returns for the company. If this is true, the non-financial reporting is relevant to investors (Doane 2002). It could therefore be assumed that market forces will drive companies to report on their social performance (KPMG, UNEP 2006). As Baums observes (2002) a law requiring public disclosure on CSR would thus be recommended only in those countries in which stock market is not efficient or is characterized by frequent failures. Market failures can arise because of externalities, asymmetric information or similar events. Under these conditions, only an adequate risk premium could encourage investors to take investment decisions. In order to reduce risk premium, some companies would report relevant information even in absence of regulatory disclosure requirements. By contrast, other companies would try to hide the risk and get a free ride on the risk reduction provided by information disclosed by the first group of companies. In the end, the market will attach the same level of risk to both categories of enterprises. This condition determines the same costs of equity, to the detriment of those companies which are already bearing the costs of voluntary disclosure.

Cost saving: mandatory disclosure would avoid any other costs for investors to obtain further information needed to assess the company's risk, performance or position.

On the contrary, other scholars (Gunningham & Grabosky 1998) point out the following weaknesses in the mandatory approach, thus providing arguments in favour of voluntary non-financial disclosure:

Knowledge gap between regulator and industry: a high degree of regulation requires a comprehensive understanding of various economic sectors, and may not be able to reflect the perception of CSR of companies, which in turn depends on the size, the business sector, the local context as well as the political and normative systems of the country.

Reduced flexibility vis-à-vis change and complexity: corporate disclosure has to be highly responsive to the various requests and rapidly changing sensitiveness of the market; a mandatory approach, by its own nature, is less flexible and needs a time lag to react to change.

Constraints on efficiency and competitiveness: in a mandatory approach companies will increase the level of information system cost, although this must be compared with economic returns (not always determinable).

Hypothesis development and data description

The survey of the European scenario has pointed out the way in which the various countries have adopted a mandatory or a voluntary approach, including compliance with the Modernization directive. It has been shown empirically that disclosure is a complex function of several factors, both internal and external to the enterprise. Models that incorporate cultural and other environmental factors have been empirically tested by several researchers (Jaggi & Low 2000; Archambault & Archambault 2003). Referring to the Spanish reform, Larringa et al. (2002) have investigated whether environmental accounting regulation is capable of increasing organisational accountability.

Starting from these results, looking at investors as primary category of stakeholders and considering listed companies as the prior subject to be observed, a statistical analysis was conducted in order to have a preliminary glace with the correlation between the development of local financial market and the position assumed by regulatory agencies on non-financial information, if any.
The hypothesis tested is indicated as follows:

H – We expect that regulatory agencies require for mandatory non-financial information depending on the degree of development of local financial markets.

The independent variables considered to measure the development of the structure of financial markets are:
1. market capitalization
2. number of domestic listed companies
3. turnover in value

The data about local financial markets, for this first observation, were collected in the twenty-seven domestic Stock Exchanges in March 2007.

Method and results

To estimate H, a multivariate analysis has been carried out, using a logit model representing a particular specification of the binary choice models. This method is generally adopted to analyse the relation between qualitative and quantitative variable.
The dependent variable (Y_i) can only take two values (1 or 0). If the regulatory agencies have adopted a law requiring mandatory non-financial disclosure (divided into the mentioned six topic areas), it assigns value 1, and 0 otherwise.
Then, there are 3 units with covariates X.
The interpretation of the β parameter estimates is as a multiplicative effect on the odds ratio (the probability divided by one minus the probability). In case of a dichotomous explanatory variable, it is the estimate of the odds-ratio of having the outcome.
The parameters are usually estimated by maximum likelihood. The stepwise method is provided to select the most relevant explicative variables.
The independent variables have been transformed in dummy (dichotomous) variables, as for the following equation:

$$Y_i = \beta_0 + \beta_1 X_1 + \beta_2 X_2 \, . \, \beta_3 X_3$$

Y*i*: presence/absence of law requiring mandatory non-financial information (where **i** varies from 1 to 6 depending on the topic areas of non-financial information: *Employment, Business processes/policies environmental impact, Business policies social impact, Customer satisfaction, Supplier, Identity).*
X_1 market cap
X_2 number of domestic listed companies
X_3 turnover in value

The regression coefficient represents the net effect exercised by a single category on the logarithm of the probability of mandatory requirement for non-financial information. The proportion of variability in a data set that is accounted for by a statistical model is almost appreciable (R2 = 0,6, although lower for Y_3 and Y_6) .

The results of the test are summarised in table 1 (Appendix 1).

The output shows the results of fitting a logistic regression model to describe the relationship between the behaviour of regulatory agencies on non-financial information (divided in six topic areas) and 3 independent variables.
The P-value for the model is less than 0.1 only in the case concerning the independent variable X_2 ("*number of listed companies*") and all soft matters as dependent variables, less Y_3 (Business policies social impact) so that there is a statistically significant relationship between the mentioned variables at 90% confidence level.
For the other independent variables (X_1 and X_3) there is no significant relationship because P-value is greater than, or equal to 0.1, indicating that the model is not significantly worse than the best possible model for these data at 90% or higher confidence level.
When Exp(B) is less than 1, increasing values of the variable correspond to decreasing odds of the event's occurrence. When Exp(B) is greater than 1, increasing values of the variable correspond to increasing odds of the event's occurrence. However, in almost all cases the Exp (b) - odds ratio - presents a result next to 1, so that each independent variable X_1, X_2 and X_3 does not influence, either positively or negatively, the variable Y_i observed; indeed, the β is near zero in almost all cases.

Moving from these results, it can be argued that only the independent variable related to the number of domestic listed companies can be related to the adoption of law requiring mandatory non-financial disclosure, except for Business policies social impact. In any case, the level of dependence is not so high as to justify a relevant influence.
For the other variables there is no a significant correlation.
It is evident that it is possible to find local requirement for non-financial information both in countries with a developed financial market and in countries with a low level of turnover or/and market capitalisation. Based on this first results, it may be argued that the request for non-financial disclosure information by many European regulatory agencies is not necessarily the result of a new business approach induced by financial markets, but could arise from either mere legal reform or increased sensibility in the social community.

First observation

Generally speaking, an enlargement could be observed of the amount of non-financial information that local law considers relevant for all stakeholders, rather than merely for investors. The influence of local law on the consciousness-raising process regarding companies CSR certainly cannot be ignored. Probably, the normative evolution on CSR in Europe reflects in a peculiar way, the American influence. Actually, on a voluntary base, CSR is the result of the consciousness and the raise of sensitivity by business and society. (Matten & Moon, 2004: 8).
As observed "*Triple bottom line reporting runs the risk of tokenism unless and until regulatory agencies are willing to mandate its requirement for a significant number of companies and provide specific guidance as to what and to whom particular social matters should be disclosed*."(Nolan 2007:12)
The requirement of local law could improve the content of annual report and provide investors with all useful information, including non-financial, so as to avoid generic and deliberately biased reports. However, this does not mean that companies do necessarily produce full non-financial disclosure or that they do have a true CSR approach. Only the content of each specific annual report will be indicative of the degree of a company's social engagement.
Nevertheless, it is necessary to ensure a minimum set of indicators, common and comparable on the market, such as environmental impact and audit, quality product, HR data (training, compliance with safety regulation, benefits), trade agreements with suppliers (i.e. compliance

with SA8000). Other kinds of non-financial information disclosed by enterprises will depend on the specific approach of the top management, and require the drafting of a specific document. In this way, it is possible to prevent companies disclosing information only for the sake of complying with standards and giving a positive image. Based on these considerations, it can be affirmed that non-financial disclosure has to be the result of companies' voluntary behaviour. In fact, if the adoption of this reporting results only from compliance with a law, the intrinsic value underlying the concept itself of social consciousness, which implies adopting proactive and spontaneous conduct, will disappear or anyway be greatly undermined.
Further researches have to be conducted to point out how companies have expanded their non-financial disclosure, as well as to establish the existence and the degree of correlation, if any, between the quality of non-financial information and the main features of financial market, in particular in Eastern European countries, in which a "new" model of capitalism probably is going to raise up.

[1] Companies Act 2006 (c. 46), Part 15 - Accounts and Reports, Chapter 5 - Directors' Report requires for listed companies " *(b) information about:*
(i) environmental matters (..
(ii) the company's employees
(iii) social and community issues, including information about any policies of the company in relation to those matters and the effectiveness of those policies".

[2] In particular, article no. 116 has generally required disclosure of social and environmental issues in annual reports and accounts since 2002. It has requested all companies listed on the "premier marche" (those with the largest market capitalizations) to report on social and environmental issues, including those related to human resources, community issues, engagement and labour standards, health, safety and environmental standards, but it does not set out the specific indicators by which a company must report on these issues.

[3] Article no. 4.18 of Vlarem stipulates that certain companies (originated from the Region of Flanders) must issue an annual environmental report.

[4] An empirical research conducted on 378 big companies points out that information disclosure is generally wide and deep, including the publication of ethic code, evidence about cost of training, relations between employees and management, costumer care, environmental impact and more.

[5] The FAR SRS is the professional institute for authorized public accountants and other highly qualified professionals in the accountancy sector in Sweden. Its SRS pronouncement "*Independent assurance of voluntary separate sustainability reports*" is accepted as the standard to be used by the accountancy firms providing sustainability assurance for Swedish companies. In 2006 it was updated to be in compliance with IFAC/IAASB's International Framework for Assurance Engagements and with the ISAE 3000.

[6] The Partners for Financial Stability (PFS) Program was create in 1999 as a public private partnership to help complete reforms necessary to have market-oriented, sound and well-functioning financial sectors in the eight Central and Eastern Europe (CEE) countries that have since joined the European Union.

[7] In particular, for Bulgaria, Cyprus, Greece, Lithuania, Latvia and Slovenia, there are no specific indications. Differently, concerning the adoption of IAS/IFRS for annual accounts of listed companies, it must be observed that Governments of Cyprus, the Czech Republic, Greece, Estonia and Lithuania and have issued the final law requiring the mandatory use of them. However, Hungary, Latvia, Poland, Slovakia and Slovenia do not require IAS adoption for annual accounts.

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Appendix 1

Table 1 – Hypotheses, variables and expected relationship

		B	Wald	P-value	Exp(B)
Y1	X1 (market cap)	,000	,494	,482	1,000
	X2 (number)	-,011	2,960	,085	,989
	X3 (turnover)	,000	,307	,580	1,000
	Constant	,751	1,067	,302	2,119

		B	Wald	P-value	Exp(B)
Y2	X1 (market cap)	,000	,501	,479	1,000
	X2 (number)	-,020	3,292	,070	,980
	X3 (turnover)	,000	,334	,563	1,000
	Constant	1,043	1,620	,203	2,837

		B	Wald	P-value	Exp(B)
Y3	X1 (market cap)	,000	,084	,772	1,000
	X2 (number)	**,006**	**2,079**	**,149**	**1,006**
	X3 (turnover)	,000	,235	,628	1,000
	Constant	-2,229	7,349	,007	,108

		B	Wald	P-value	Exp(B)
Y4	X_1 (market cap)	,000	,025	,875	1,000
	X_2 (number)	,006	3,524	,060	1,006
	X_3 (turnover)	,000	,002	,960	1,000
	Constant	-3,493	8,409	,004	,030

		B	Wald	P-value	Exp(B)
Y5	X1 (market cap)	,000	,025	,875	1,000
	X2 (number)	,006	3,524	,060	1,006
	X3 (turnover)	,000	,002	,960	1,000
	Constant	-3,493	8,409	,004	,030

		B	Wald	P-value	Exp(B)
Y6	X1 (market cap)	,000	,069	,793	1,000
	X2 (number)	,004	2,728	,099	1,004
	X3 (turnover)	,000	,014	,907	1,000
	Constant	-2,127	7,651	,006	,119

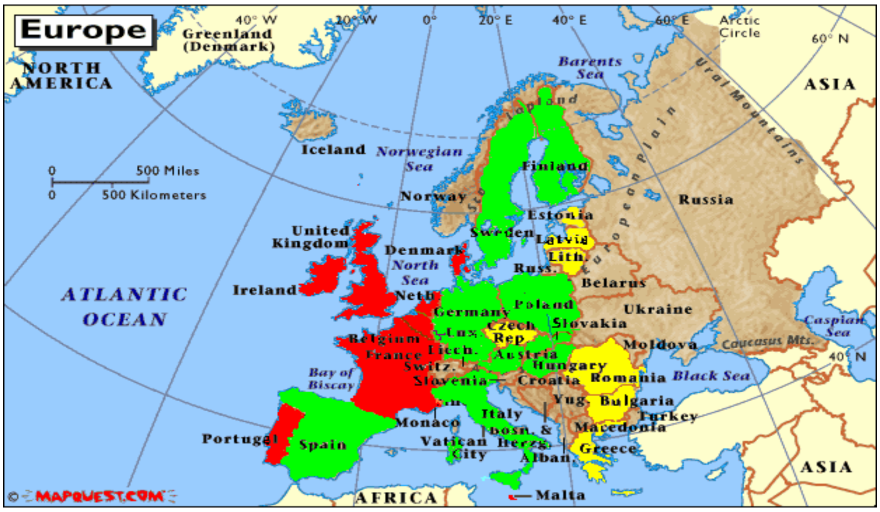

Figure 1 Empirical results in Europe

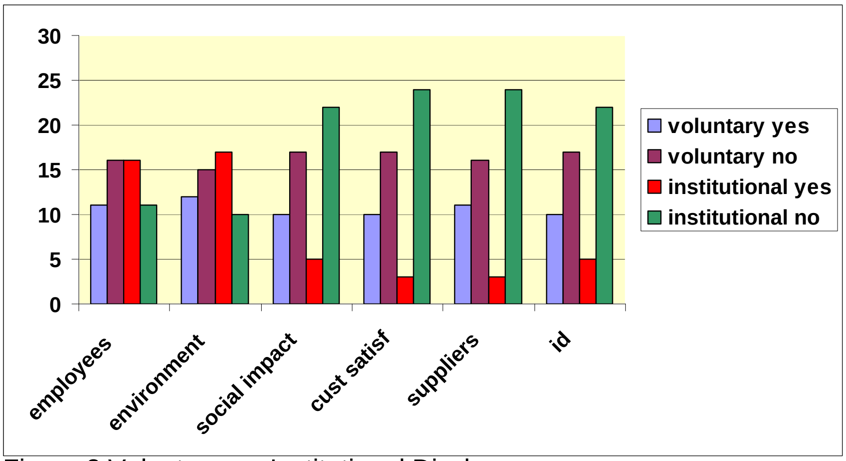

Figure 2 Voluntary vs. Institutional Disclosure

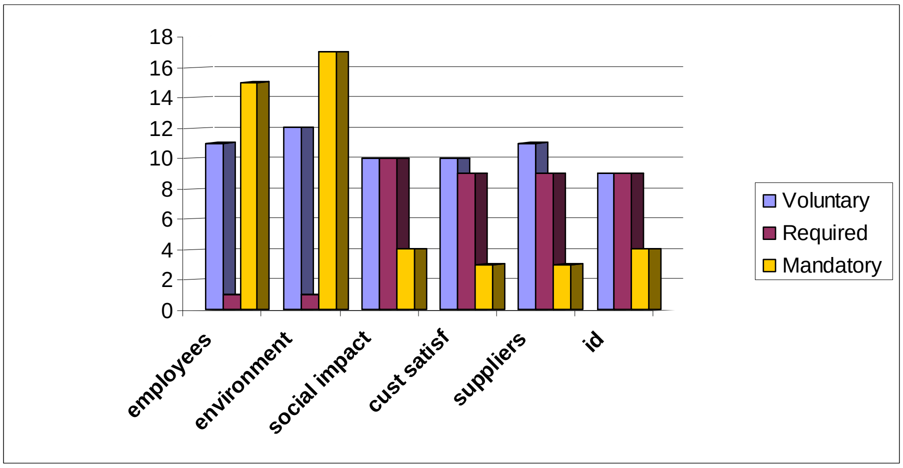

Figure 3 Disclosure on non-financial information