New Challenges of Financial Communication in the Context of Sustainability Standards

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Abstract

Companies face a diverse range of challenges and opportunities that have a significant impact on their long-term sustainability. This range includes factors such as climate change, resource limitations, urbanization and technological advances. Investors should evaluate the impact of these factors on companies to guide their investment choices. Stakeholders worldwide are looking to assess how companies manage sustainability risks and opportunities. They need access to standardized, comparable data, essential information in the decision-making process. The paper explores integrating sustainability standards in investment and governance, focusing on the ISSB's impact. Objectives include assessing their effectiveness for investor information, enhancing transparency, and promoting sustainable finance. The research analyzes the evolution, specific goals, and implications of these standards on decision-making and reporting.

Key words: financial communication, sustainability standards, integrated reporting, investors, decision
JEL classification: F64, L15, O13

1. Introduction

The paper aims to explore the integration of sustainability standards in investment decision-making and corporate governance practices, focusing on the impact of initiatives such as sustainability standards and the formation of the International Sustainability Standards Board (ISSB). The article aims to investigate the effectiveness of these standards in addressing the information needs of investors, enhancing corporate transparency and promoting sustainable financial practices.

The research examines the evolution of sustainability standards, and deepens the specific objectives of these standards, assessing their role in communicating consistent, comparable and high-quality sustainability information. The study also explores the implications of these standards for investor decision-making, corporate reporting strategies and risk management practices.

2. Theoretical background

Establishing sustainability principles is becoming an increasingly important concern in accounting and financial reporting, leading to increased recognition of general sustainability reporting standards and harmonization of reporting (Thejo, 2017, p.257). For instance, private enterprises aspire to enhance openness, boost brand worth, credibility, and legitimacy, enable comparison with industry peers, convey competitiveness, inspire staff, and aid corporate data and control procedures through the disclosure of sustainability details (Herzig *et al*, 2006, p.302). Furthermore, sustainability reporting is rapidly being considered as a critical aspect in business sustainability (Lozano *et al* , 2011).

International Financial Reporting Standards (IFRS) have evolved over several decades and were developed by the International Accounting Standards Committee (IASC) and later by the International Accounting Standards Board (IASB). These standards have become a significant influencer on the quality of financial reporting of companies globally, and we aim to identify how IFRS affects the quality of financial reporting by promoting transparency, comparability and relevance of information.

Currently, IFRS is a global standard in financial communication, and the IASB continues to develop and update the standards to meet the ever-changing needs of the international business environment.

In November 2021, the International Financial Reporting Standards Foundation - IFRS presented the strategic initiative to establish the International Sustainability Standards Board (ISSB), with the main objective of formulating a globally applicable framework of standards of sustainability reporting. The International Sustainability Standards Board aims to simplify the global sustainability communication environment by reducing the complexity associated with multiple reporting sources, while building on the experience and practices associated with high-quality frameworks and standards.

The standards developed by *the Sustainability Accounting Standards Board (SASB)* address information needed by investors, focusing on parameters specific to various business areas and explore risks and opportunities affecting cash flows, communication and financial accessibility and costs with obtaining borrowed sources. Thus, companies in different fields of activity can use the relevant standards for their sector to report specific and meaningful information related to sustainability. This aspect facilitates the integration of sustainability factors into investment and management decisions in various global portfolios. In addition, SASB standards play a vital role in communicating to investors information that supports the ecosystem as a whole.

The Council for Accounting Standards in the field of Sustainability proposes four main objectives that are embodied in:

- creating standards for a universal basis that aims to communicate information on sustainable development;
- meeting the information requirements of investors;
- motivating companies to communicate full information on the sustainability of global capital markets;
- ensuring the compatibility of communicated reports and adapting them to some specific jurisdictions or to wider groups of stakeholders.

The Council for Accounting Standards in the field of Sustainability, through these objectives, ensures a bridge between companies and stakeholders, the latter being correctly informed about the global sustainable development strategy, meeting the information requirements of investors and ensuring the compatibility of reported data.

3. Research methodology

The research method is based on a predominantly deductive approach, starting from the role of sustainability standards in the communication process, from the importance of presenting the fundamental notions of sustainability standards and continuing with the selection and synthesis of available information on the researched field, likely to allow opinions and documented conclusions that are useful in making sustainability decisions that have a direct impact on cash flow, access to finance and capital expenditure.

4. Findings

Many stakeholders from different fields see sustainability reporting as a component of the annual report that helps the firm monitor environmental performance and build its own corporate sustainability metrics (Bundy *et al* , 2013, p. 370, Lozano, 2015, p. 42).

In other words, sustainability reporting should be seen as a tool capable of helping firms become aware of their strengths and weaknesses, as well as identify specific interdependencies within them (Köppl et al , 2004, pp. 293–314) .

Onicioiu et al. (2020, p.9) highlight the significance of businesses embracing sustainable strategies and goals. They advocate for a comprehensive approach, valuing the viewpoints of stakeholder groups when contemplating sustainability reporting. This involves considerations such as employee training and the delineation of responsibilities among groups involved in the development of sustainable practices. The authors also emphasize the positive outcomes derived from the reporting process. Consequently, the sustainability report functions as a dual-purpose tool, serving both as a promotional instrument for the enterprise and as a readily accessible source of information for consumers, existing and prospective investors, and other stakeholders. It provides insights into the tangible impact of the enterprise's activities on society and the environment.

The challenges brought to financial communication by the sustainability standards, issued by the SASB, are highlighted in particular by *IFRS S1 "General requirements for the development of financial information related to sustainability"*. The purpose of the standard IFRS S1 "*General requirements for the development of financial information related to sustainability"* is to oblige companies to communicate information on risks and opportunities related to sustainability, information beneficial to the primary users of financial reports and to potential investors in the process of allocation of resources.

Primary users benefit from information about sustainability risks and opportunities as the entity's cash flow generation across short, medium, and long-term horizons hinges on intricate interactions with stakeholders, society, the economy, and the environment. The entity operates within an interlinked system, encompassing existing resources and interactions. These resources and relationships, whether natural, self-created, intellectual, human, social, or financial, collectively shape and influence the entity. Also, these resources can be internal, such as the company's personnel, know-how, or organizational procedures, or external, such as the materials and services the business requires, or connections with suppliers, distributors, and consumers.

This standard specifies how an entity should prepare and communicate information related to sustainability and, at the same time, establishes general guidelines for the content and presentation of information relevant to key users in making decisions about the allocation of resources needed by companies.

Reporting entities provide financial information that primary users can use to make decisions about allocating and/or resourcing the entity's needs . These decisions involve choices regarding:

- buying, selling or holding shares and debt instruments;
- granting or repaying loans and alternative credit arrangements;;
- the exercise of voting or other influences on the activity of the management of the company that affect the use of economic resources by it.

Financial sustainability information holds value when it is pertinent and faithfully reflects the reality. Thus, relevance and faithful representation become important qualitative attributes of communication. Financial information on sustainability is more valuable if it is comparable, verifiable, timely and clear. Comparability, verifiability, timeliness and comprehensibility are properties that enhance the usefulness of financial information related to sustainability.

To increase the effectiveness of communication in the field of sustainable development, IFRS S1 "General requirements for the development of financial information related to sustainability" regulates the importance of providing information on:

- entity's governance through showcasing processes, controls, and procedures employed to oversee and address sustainability risks and opportunities;
- entity strategy, ie the methods used by the entity to manage the risks and opportunities associated with sustainability;
- risk management which involves presenting the methods an entity uses to identify, analyze and manage risks;
- indicators and objectives designed to assess the entity's performance concerning sustainability risks and opportunities. This includes tracking progress towards targets established by the company or mandated by relevant legislation.

Within sustainability reporting, an entity is required to reveal information facilitating comprehension of sustainability-related risks and opportunities affecting the company's outlook for users of general-purpose financial reports. The entity must:

- outline sustainability risks and opportunities influencing the entity's prospects.
- specify the anticipated timeframes—short, medium, or long term—when the effects of each sustainability risk and opportunity are expected to materialize.
- define time horizons and how they relate to the planning process.

The Board for Accounting Standards in the field of Sustainability, through IFRS S1, took over and adapted part of the definitions and general requirements from the Conceptual Financial Reporting Framework issued by the IASB to be completed with the full name and from the International Financial Reporting Standards (IFRS), and in this case from IAS 1 *Presentation of financial statements* and IAS 8 *Accounting policies, changes in accounting estimates and errors*, which ensures on the one hand a continuity of the standardization process of information communication and on the other hand an adaptation to the new trends and needs that it manifests itself in society.

Through sustainable reporting standards, the traditional framework of financial communication is overcome. In this context, the role of management becomes crucial in determining risks and opportunities. Sustainability reporting and climate risk assessment are complex and interconnected fields that require innovative and adaptive approaches. The implementation of relevant standards and guidelines, such as those developed by the International Sustainability Standards Board (ISSB) and the International Accounting Standards Board (IASB), provide an important framework for communication by companies of information on managing possible challenges and opportunities. The evolution and adaptation of these standards in the future will be essential to meet the ever-changing challenges of the global business environment.

Sustainability reporting is an expensive tool to begin with, but ultimately increases company value as organizations improve their ability to communicate sustainability efforts to stakeholders and investors become more adept at evaluating the quality of reports (Alghamdi et al, 2023, p.1).

5. Conclusions

The value of the Standards developed by the Accounting Standards Board in the area of Sustainability is primarily due to the fact that they allow investors to access corporate sustainability reports that are not only comparable and consistent, but also have a direct impact on crucial components such as cash flows of a company, financial accessibility and cost of capital. In addition, these standards help investors identify key issues for corporate governance engagement, allowing them to focus their efforts on company strategies.

In addition, the SASB standards improve the quality of fundamental analysis of equity and debt capital in both public and private markets. By incorporating a wider range of information beyond financial statements, investors gain a comprehensive understanding of companies' financial health and potential risks. These standards also contribute to the expansion of risk assessment by including sustainability risks. This comprehensive approach gives investors a holistic view of a company's risk profile.

Sustainability reporting has become a core element in the investment decision-making process, as a result of the growing demand for companies to provide high-quality, globally comparable information on risks and opportunities related to sustainability. This request for information is underlined by the feedback received, in the communication process of the entities, through the consultations with the capital market participants. Sustainability standards, on the one hand, provide invaluable support to investors and, on the other hand, play a crucial role in helping companies around the world recognize, measure and manage the sustainability risks and opportunities that they have a direct impact on cash flow, access to finance and capital expenditure.

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