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THE IMPORTANCE OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) AND THE NEW SUSTAINABILITY REPORTING STANDARDS, IFRS S1 AND IFRS S2, IN SUSTAINABLE BUSINESS DEVELOPMENT IN THE US

Abstract. In a rapidly globalizing world marked by globalization and harmonization of financial reporting principles and standards as well as increasing environmental concerns and a clarion call for corporate transparency, new IFRS financial reporting standards such as IFRS 17 and non-financial sustainability reporting IFRS S1 and IFRS S2 standards have emerged as significant markers for the competitive advantage of a company. The United States, with its dominant position in the global business landscape, offers a unique perspective on the integration and implications of these standards, making exploring this topic especially pertinent. The purpose of the study is to clarify the criticality of the need to implement new IFRS financial reporting standards, such as IFRS 17 for US companies, as well as IFRS S1 and IFRS S2 for sustainable business development in the US. The study investigates how these standards can drive transparency, facilitate informed investment decisions, and catalyze a shift toward sustainable business practices in the American corporate ecosystem. A mixed-methods approach was employed, and supplementary data were sourced from relevant literature, institutional reports, and regulatory policy documents. Research results indicate a growing recognition among US businesses of the benefits of aligning US companies’ reporting with IFRS S1 and IFRS S2, including enhanced investor trust, competitive advantage, and better risk management. The research underscores the potential of IFRS S1 and IFRS S2 to act as catalysts for sustainable business development in the US.
**Keywords:** International Financial Reporting Standards, IFRS 17, IFRS S1, IFRS S2, Sustainable Business Development, Corporate Transparency, Sustainability Reporting, US Business Landscape.

**Formulation of the problem.** In an era where the drumbeat for sustainable development reverberates globally, the roles of governments, large corporations, big businesses, and even small enterprises have never been more pivotal. As countries strive to create equilibrium between economic growth, social equity, and environmental protection, the focus is increasingly shifting towards how businesses can be conduits for sustainable practices. The essence of corporate accountability has evolved to include not just financial success but also social responsibility and environmental stewardship.

The Generally Accepted Accounting Principles (further ‘GAAP’) are the bedrock of business financial reporting in the United States. However, this standardized system is often lacking in provisions for evaluating and reporting on the environmental impact of business operations. This creates a glaring oversight, especially when sustainability is continuously becoming a very important strategy and governance tool and especially important for ‘Value Seeking Investors’.

Contrast this with the accounting landscape in European countries, where International Financial Reporting Standards (IFRS) have been expanded to incorporate two new standards — IFRS S1 and IFRS S2 — specifically designed to capture information regarding a business's environmental footprint. Currently, these more encompassing standards are only utilized by joint ventures and foreign businesses operating in the United States, leaving a significant portion of American businesses trailing in the adoption of accounting measures that reflect sustainable practices.

The urgent question that looms is: Is it time for American businesses to align their accounting standards with global practices? In a world increasingly interested in solving the climate crisis, diminishing natural resources, and heightened social awareness, can businesses afford not to take responsibility for the world we all share?

As we delve into this discussion, we seek to explore the imperative for transitioning to accounting standards that not only reflect but also drive sustainable development, offering a more holistic picture of corporate performance and responsibility.

**Analysis of recent research and publication.** Literature on standards and their significance in sustainable development has been varied and comprehensive. Avi [1] delved into the relationship between financial reporting and sustainability [Avi 1], emphasizing how the IFRS S1 draft bridges the gap between these two realms, offering a holistic view of external corporate disclosure. Goettsche [2], on
the other hand, unveiled the double-edged nature of materiality in sustainability disclosure standards, suggesting that while these standards may promote transparency, they could also have unintended consequences. Indyk [5] took a more regional approach, assessing the readiness of companies in Poland for sustainability reporting under the ED IFRS S1 and S2 [Indyk [5]], providing insights into the European context. KPMG’s survey in 2022 [6] elucidated the gradual transition in sustainability reporting, highlighting the incremental changes companies are making. This is complemented by Lexology’s [7] quick insights into how the ISSB's IFRS S1 and S2 have begun to shape the corporate landscape regarding sustainability. Morrow Sodali [8] offered an in-depth examination of the two standards, enriching the understanding of their operational details. Rafi’s [9] work emphasized the indispensability of sustainability for corporate strategy, echoing the sentiment that sustainability isn't a mere addendum but central to modern business thinking. Lastly, Rouen, Sachdeva, and Yoon [10] traced the evolution of ESG reports, explaining the pivotal role of voluntary standards in this evolution. In synthesis, while existing literature offers a rich tapestry of insights on the integration of standards in sustainable development, there remains a vacuum regarding the importance of IFRS S1 and IFRS S2 in sustainable business development in the US. Given this identified gap, new research in this area is not just relevant but critical.

The purpose of this research. The study aims to systematize information for a comprehensive understanding of the importance of integrating IFRS financial reporting standards, such as IFRS 17, as well as IFRS S1 and IFRS S2, in sustainable business development in the United States.

Presenting main material. The financial reporting landscape in the United States is dictated by various rules and regulations to ensure accuracy, transparency, and reliability. These standards are crucial in aiding investors and stakeholders to make informed decisions.

The United States Generally Accepted Accounting Principles (US GAAP) is the primary set of accounting rules and standards that most companies in the U.S. must follow. Within the US GAAP, attention has gradually turned to sustainable development. This is due to a global trend towards recognizing the importance of sustainability reporting and the environmental, social, and governance aspects in financial disclosures driven by IFRS 17 and other IFRS financial reporting standards. The Financial Accounting Standards Board (FASB) has acknowledged the significance of these issues. However, it should be noted that, to this day, the US GAAP doesn't have a specific section dedicated exclusively to sustainability. Today, the Securities and Exchange Commission introduced potential rule modifications. These changes would mandate that companies incorporate specific quantitative and qualitative climate-related items in their registration documents and routine reports. This includes data on climate-associated dangers that could significantly influence
their business performance, operational outcomes, or financial status. Additionally, they would need to present specific financial metrics related to the climate in an appendix to their vetted financial reports. The demanded details on climate risks would also cover a company's carbon emissions, a frequently employed measure to evaluate a company's vulnerability to these risks.

Given the increasing importance of sustainability in global business, adopting IFRS standards might be beneficial for U.S. companies for several reasons:

- **Global Consistency.** IFRS is used in over 50 countries, allowing for more uniform reporting and making it easier for investors and stakeholders to compare companies across borders.
- **Sustainability Emphasis.** IFRS has shown a progressive attitude towards sustainability. The International Accounting Standards Board (IASB) has initiatives to advance the integration of sustainability factors in reporting.
- **Meeting Investor Demand.** As ESG (environmental, social, governance) investing becomes more prevalent, investors seek more standardized and comprehensive sustainability disclosures. Companies using IFRS may be better positioned to address these demands.

International Financial Reporting Standards (IFRS) are a set of globally recognized financial reporting guidelines that have, over the years, integrated provisions related to sustainable development [11]. These provisions can be found interspersed throughout various sections of the standards, emphasizing the importance of considering environmental, social, and governance (ESG) aspects in financial reporting. Some highlights are:

- **IAS 16 – Property, Plant, and Equipment:** Companies might need to recognize provisions for decommissioning costs, particularly relevant for sectors like oil and gas, where environmental restoration and rehabilitation requirements exist. Tolkach [12] writes that during the property valuation process design efficiency can have an impact on energy costs and operating expenses and sustainability. Tolkach [12] provides the following examples: water reuse can mean lower expenses for water; solar energy use, meaning high initial expenditure on solar panels but lower energy costs in consequent periods; occupancy sensors also meaning certain higher initial costs of the equipment and lower electricity bill at the end of the period should be considered.
- **IAS 36 – Impairment of Assets:** Environmental issues could lead to the impairment of assets. For instance, stricter environmental regulations might render certain assets obsolete.
- **IAS 37 – Provisions, Contingent Liabilities, and Contingent Assets:** Companies might need to recognize provisions for environmental clean-up or potential fines and penalties related to environmental breaches. Tolkach [12] mentions that examples of provisions can serve ‘an expense such as provision for
an income tax, contra asset account such as allowance for bad debts and allowance to reduce securities from cost to market value; making an appropriation of retained earnings for a specified purpose’ ([13] Siegel & Jae, 2005Siegel, J.G., Jae K. S., 2005, page 353). Tolkach [12] concludes in an earlier study that International Accounting Standards provision balances can be based on legal obligations and on contingent liabilities. Tolkach [12] writes that provision for biomass is especially important. Entities involved in biomass processing and distribution, regulators and communities on what adjustments are needed to improve the biomass sustainability. Moreover provisions under IFRS might contain provisions related to asset disposal obligation. Tolkach [12] says that under US GAAP asset disposal obligation (asset retirement obligation, ARO) provision reflects the expected cost of taking care of removal of a certain asset. Tolkach [12] concludes that we expect that high expected costs of such disposal the more significant the environmental impact of such asset retirement.

- Tolkach [12] finds that in order to establish the link between litigations elements in the financial reporting and sustainability we refer to valuation literature and we find theoretical support in sustainability and income producing property valuation paper focused on North America (Austin, 2012). Tolkach [12] writes that to establish a logical relation between LEEDigations and sustainability performance we chose to select a couple of characteristics mentioned by Austin (2012) that we find most relevant to sustainability, namely ‘improperly designed or constructed sustainability aspects, an owner’s or tenant’s unsatisfied expectations, completed buildings not achieving the expected rating,

- Tolkach [12] writes that Research and Development expenses that help to develop new products and are likely to move towards more innovative and sustainable solutions (for example in decreasing waste, more innovative and sustainable packaging, materials, development of such materials by packaging manufacturers etc. – depending on the operations and industry of the company), we expect that the higher these expenses are the better CSP of a firm. Tolkach [12] concludes that the reasons for a positive correlation between R&D and innovation expenses and CSP to exist seem to be significant. The more a company invests in progress and moving forward, the more it contributes to sustainable development. This item can be measured by monetary balances per period end.

- Tolkach [12] explores that ‘Personnel costs’, also called ‘staff costs’ or ‘employee costs’ include but are not restricted to expenditures such as wages paid to employees and officers of the company, employee benefits, health insurance and contributions to pension plans (Thomson Reuters, 2013, p584). Tolkach [12] says that how personnel costs captures social responsibility sometimes can be found directly in financial statements of a company.

- IAS 1 – Presentation of Financial Statements: This standard dictates the general presentation of financial statements. Environmental liabilities or assets, if material, need to be presented appropriately in the balance sheet.
• IAS 38 – Intangible Assets: Companies might capitalize certain environmental-related intangible assets, such as carbon credits.

• IFRS 6 – Exploration for and Evaluation of Mineral Resources: This standard addresses the environmental rehabilitation requirements for exploring and evaluating mineral resources.

• IFRS 13 – Fair Value Measurement: The environmental condition of an asset or a liability and the associated costs could influence its fair value.

In addition, many companies, recognizing the growing importance of environmental issues, voluntarily provided more detailed environmental and sustainability information in their annual reports and other communications, often as a part of a broader ESG (Environmental, Social, Governance) reporting framework. However, introducing the new IFRS S1 and S2 standards in 2023 marks a significant step forward. These measures are projected to bolster reliability and transparency in corporate reports, thus influencing informed investment choices.

IFRS S1 offers a structured guideline for businesses to elucidate the sustainability-related challenges and prospects they predict in short- and long-term prospective. Conversely, IFRS S2, intended to complement IFRS S1, contains precise disclosure criteria concerning climate issues. Both IFRS S1 and S2 notably integrate suggestions from the Task Force on Climate-related Financial Disclosures. This innovative initiative signals a pivotal transition, merging the realms of finance and ecological responsibility. For a more detailed exploration, refer to the article 'New Global Sustainability and Climate-related Disclosure Standards: Implications for Australian Enterprises' [7]. Having studied the successful experience of implementing reporting standardization among people in business, we can summarize the key strengths of IFRS S1 and IFRS S2 [4]:

- **Robust, Comparable, and Verifiable Disclosures.** The standards have been designed to allow companies to provide sustainability disclosures in a consistent and verifiable manner. This robustness and comparability will aid in better investment decision-making.

- **Globally Comparable Sustainability-Related Disclosures.** The standards, backed by the G20 and others, aim to offer globally consistent sustainability-related disclosures. This will reduce duplication in reporting and provide more clarity to investors and stakeholders.

- **Supports Price Discovery and Capital Formation.** High-quality data from the ISSB Standards will aid in price discovery and capital formation and foster efficient capital markets.

- **Reduced Fragmentation and Enhanced Comparability.** The global economy benefits from common reporting standards, reducing fragmentation and promoting comparability in climate-related financial data.

- **Foundation for Climate-Related Financial Information.** The ISSB Standards, set a global baseline for companies to disclose relevant climate-related financial data. This data will be pivotal in transitioning to a low-carbon economy.
- **Comprehensive Understanding of the Company’s Performance.** The standards will provide consistent and comparable sustainability information, which, when paired with financial details, gives a holistic view of a company’s performance and commitment to sustainable value creation.

- **Global Alignment and Avoidance of Double Reporting.** A globally accepted standard is essential to clearly understand a company’s sustainability performance. It enables comparability of disclosures globally and prevents the potential for double reporting in different jurisdictions, which could lead to unnecessary costs and reduced comparability.

- **Integration into Regulatory Frameworks.** There’s a strong call for jurisdictions worldwide to adopt and integrate the ISSB Standards into their regulatory frameworks to ensure consistency and comparability.

Let us consider the relationship between IFRS financial reporting and sustainability reporting in Table 1.

**Table 1- Expected relationship between IFRS financial reporting and sustainability**

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<tr>
<th>Independent variable</th>
<th>Main factors of influence</th>
<th>Literature support</th>
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Note: systematized by the author [12]
U.S. businesses display a mixed readiness to transition to ED IFRS S1 and S2 standards. Both ED IFRS S1 and S2 adopt a risk-centric approach, pinpointing sustainability and climate-related risks and positive scenarios. These standards then evaluate their influence on a business's strategy, model, and fiscal outcomes across short-, medium-, and long-term horizons. This extends beyond merely enhanced disclosure mandates—it signifies foundational shifts within business infrastructures, incorporating solid ESG risk controls, effective reporting mechanisms, and comprehensive policies.

These drafts are emblematic of the prevailing sustainability movement, echoing initiatives like the Corporate Sustainability Reporting Directive (known as ‘CSRD’).

Ultimately, the introduction of ED IFRS S1 and S2 will induce notable alterations in financial disclosures. As the ESG paradigm surges, most companies will undergo a reporting metamorphosis, essentially crafting sustainability-tied financial statements anew. The paramount hurdle lies in quantifying the repercussions of sustainability and climate-centered risks and benefits of these statements. This demands refining risk evaluation methodologies and pioneering holistic reporting frameworks.

**Conclusions.** The advantages of IFRS S1 and IFRS S2 include providing robust, comparable, and verifiable sustainability disclosures that enhance investment decision-making, fostering globally consistent sustainability-related reporting that reduces duplication, aiding in price discovery and capital formation, promoting transparency in climate-related financial data, establishing a universal language for sustainability reporting, offering a comprehensive understanding of a company’s performance in conjunction with financial data, bolstering Asian capital markets through standardized disclosures, ensuring global alignment in sustainability reporting, and preventing potential double reporting across jurisdictions, all of which culminate in a universally accepted standard essential for clear and comparable views of companies' sustainability performance.

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