The Challenges and Consequences of Implementing Sustainability Disclosure Standards in Financial Reporting: A Study of SAFA Region[1]

Research conducted by Prof. Roshan Ajward and Dr. Sandya Kumari for South Asian Federation of Accountants (SAFA)

Overview: The adoption of Sustainability Disclosure Standards is reshaping how companies report on environmental, social, and governance (ESG) practices. With increasing pressure from stakeholders and regulatory bodies, businesses must now disclose their sustainability efforts in a transparent and standardized manner. This research breaks down the key findings of a study conducted in the South Asian Federation of Accountants (SAFA) region, analyzing the challenges, benefits, and variations in implementing these standards. The goal is to help entities, professionals and other stakeholders understand the significance and practical implications of sustainability reporting. The findings of study carry significant policy implications and recommendations.

Introduction

Sustainability is no longer just a buzzword; it is a critical element in how companies report their activities to stakeholders. Global businesses are being asked to disclose how they impact the environment, society, and governance (ESG). To make this easier and more transparent, the International Sustainability Standards Board (ISSB) introduced Sustainability Disclosure Standards, including the IFRS S1 and S2, which took effect on January 1, 2024.

These standards aim to provide clear, consistent, and reliable sustainability reporting. Investors, regulators, and the public can use this information to evaluate how companies manage their sustainability practices and risks.

[1] The full research study is available on request. Please contact us via: ajward@sjp.ac.lk or skjayasena@mgt.rjt.ac.lk

Why Does This Matter?

- **Transparency**: Companies can showcase how they address ESG concerns.
- **Investor Confidence**: Investors need reliable data to assess risks and opportunities.
- **Global Alignment**: Companies align with international sustainability goals, such as the UN Sustainable Development Goals (SDGs).
- **Regulation**: Governments are increasingly requiring sustainability disclosures.

However, implementing these standards is not without its challenges, especially in developing regions as South Asia (SAFA region). This study simplifies the insights from our study on the obstacles and outcomes of applying these standards in financial reporting.

Key Objectives of the Study

This study addressed following key objectives.

1. Identify the **challenges** of implementing IFRS S1 Sustainability Disclosure Standards.
2. Understand the **consequences** (positive and negative) of these standards.
3. Evaluate the **importance, difficulty, and timing of disclosures** on Governance, Strategy, Risk Management, Metrics and Targets, General Requirements.
4. Assess how these challenges vary across countries, industries, company sizes, and professional backgrounds.

How the Study Was Conducted

Our research was based on a comprehensive structured questionnaire sent to financial professionals across the SAFA region. Out of 2,650 distributed questionnaires, 182 responses were analyzed. The study looked at companies of different sizes and industries, helping us gather broad insights. The analyses were performed by using accepted various statistical techniques that are consistent with the research methodology adopted in this study.

Findings and Key Insights

1. The Challenges of Implementation

Findings of the study indicated that financial and human resource limitations stood out as major barriers. Participants indicated that companies often lack the budget and skilled staff needed to meet the new disclosure requirements. Many also face technological constraints, lacking systems to track and report sustainability data.

Other notable challenges include:

- **Cultural Resistance**: Some companies are hesitant to shift from profit-focused models to sustainability-driven approaches.
- **Short-term Thinking**: Sustainability goals often conflict with immediate financial targets.
- **Data Gaps**: Collecting quality data for reporting is difficult.
- **Complex Regulations**: Companies struggle to interpret and apply international sustainability guidelines, leading to inconsistent reporting practices.
- **Sector-Specific Barriers**: Industries such as manufacturing report greater difficulties in integrating sustainability standards compared to service sectors.

Companies that overcame these challenges invested in technology, trained their staff, and promoted a sustainability-focused company culture.

2. The Positive Outcomes

Despite the difficulties, the participants indicated that companies could derive several benefits by S1 related disclosures:

- **Greater Transparency**: Enhanced trust and credibility with stakeholders.
- **Better Stakeholder Relationships**: Improved engagement with investors and customers.
- **Long-term Value**: Sustainability efforts led to better strategic planning and brand reputation.
- **Risk Management**: Companies better identified and mitigated sustainability risks.
- **Market Competitiveness**: Adopting sustainability practices positioned firms as leaders in responsible business, attracting investors and talent.

However, areas like employee engagement and innovation saw less immediate benefit, suggesting that long-term efforts are needed to unlock these advantages fully.

3. Importance vs. Difficulty of S1 Disclosures

Participants highlighted four key areas for sustainability reporting:

- **Governance**: Clear responsibilities and accountability structures are essential.
- **Strategy**: Sustainability must be part of the company's long-term vision.
- **Risk Management**: Companies need to identify and manage sustainability-related risks.
- **Metrics and Targets**: Clear performance measures are necessary to track progress.

While these areas were seen as difficult to implement, requiring significant investment and planning, they were also considered to be important.

Additional findings indicated that companies prioritize governance and strategic planning as the most crucial components. However, they face significant difficulties in setting measurable targets and establishing comprehensive metrics that align with international standards.

Applicability of Standard Frameworks – Participants indicated that IFRS Sustainability Disclosure Standards (ISSB) and Sustainability Accounting Standards Board (SASB) are the most applicable frameworks for sustainability reporting, followed by Global Reporting Initiative (GRI). Climate Disclosure Standards Board (CDSB) and European Sustainability Reporting Standards (ESRS) have lower applicability scores and may require more effort for adoption. Prioritizing ISSB and SASB while considering regional or sectoral needs is recommended.

Preferred Location of Disclosure – Analyzing the responses of research participants, it is observed that there is a shift toward using Integrated Reports and Strategic Reports for sustainability disclosures, as companies align sustainability goals with business strategy. Operating and Financial Reviews and Management Reports are considered less effective. Integrated Reports pose the greatest challenge for incorporating sustainability-related disclosures, while Strategic Reports and Operating and Financial Reviews offer easier integration.

4. **Demographic Differences**

The study found that larger companies generally faced fewer challenges due to greater resources and established sustainability frameworks. Smaller firms, however, struggled more with implementation. Companies in manufacturing faced distinct hurdles compared to service-based industries.

Key demographic insights:

- **Country-Specific Variations**: Countries with stronger regulatory frameworks in the SAFA region saw faster adoption of sustainability standards.
- **Industry-Specific Trends**: Manufacturing and resource-heavy sectors reported greater barriers compared to tech and financial services.
- **Firm Size**: Larger organizations had better access to technology and expertise.

Interestingly, factors like age, education, and professional experience had less influence on the perceived challenges. Instead, organizational factors like industry and country-specific regulations played a more significant role.

Key Recommendations

Following key recommendations both for companies and SAFA are suggested based on our findings.

a. For Companies

1. **Invest in Training and Technology**: Building internal expertise and data systems is crucial.
2. **Leadership Commitment**: Sustainability efforts need to start at the top.
3. **Integrate Sustainability into Strategy**: Align long-term business goals with sustainability objectives.
4. **Start Small**: Focus on key metrics first and expand gradually.
5. **Engage Stakeholders**: Regular communication with investors and the public can drive accountability and support.
6. **Tailor Approaches by Sector**: Customize strategies to fit specific industry challenges and regional regulations.

b. For SAFA as an Apex Professional Accounting Body

1. **Develop Regional Guidelines**: SAFA should advocate tailored sustainability reporting frameworks that align with international standards but reflect regional needs and capabilities.
2. **Capacity Building Programs**: SAFA can organize training workshops and certification programs to build expertise among financial professionals in the region.
3. **Promote Cross-Border Collaboration**: Encourage collaboration between SAFA member countries to share best practices and resources for sustainability reporting.
4. **Advocacy and Policy Influence**: SAFA should work closely with governments and regulatory bodies to influence policies that facilitate easier adoption of sustainability standards.
5. **Support for SMEs**: Develop simplified guidelines and toolkits that small and medium enterprises (SMEs) can use to comply with sustainability disclosure requirements.

Conclusion

Sustainability disclosure is becoming a business necessity. While implementing IFRS S1 standards can be challenging, the long-term benefits far outweigh the costs. Companies that prioritize sustainability now will gain a competitive edge, ensuring resilience and success in an increasingly ESG-driven market.

By embedding sustainability into their core strategies, businesses not only mitigate risks but also unlock new growth opportunities, attract forward-thinking investors, and build stronger connections with stakeholders. In an era where stakeholders value transparency and accountability, sustainability reporting is not just an obligation; it is a pathway to long-term success and leadership in a rapidly evolving business environment. As an apex accounting body the South Asian Federation of Accountants is expected to play a key role in adopting and promoting sustainability accounting standards in the South Asian region.