

Accountants and Sustainability Reporting

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Abstract

This study enhances the understanding of sustainability reporting by examining Icelandic auditors' readiness to engage with existing sustainability frameworks. In collaboration with the Association of Certified Public Accountants in Iceland, a survey was conducted in 2022. The results highlighted a significant gap in knowledge and experience among Icelandic auditors regarding eight specific sustainability frameworks—which, notably, lacked any legal audit requirements at the time. In a similar survey in the United States focused on auditors' familiarity with sustainability reporting within financial statements and their practical experience in this area came to comparable conclusions. To build on these findings, future research could utilize qualitative interviews to delve deeper into auditors' perspectives and practices, particularly within audit teams. Exploring how audit firms develop expertise in sustainability reporting practices could also yield important insights into effective strategies. This study points to a critical need for improved education and training in sustainability reporting. The recent requirement for mandatory audits of sustainability reports—introduced after our survey—underscores the urgency of addressing these educational gaps.

Keywords: sustainability, governance, auditors

1. Introduction

Sustainability accounting is an important advancement to enhance financial reporting. The importance of robust financial reporting should center on driving sustainable development and enduring financial reliability. An external audit plays a pivotal role as a monitoring mechanism to ensure such reliability (Corten et al., 2021).

The framework for disseminating information holds paramount importance for investors, markets, and the wider community. Ensuring equitable access to information is essential to maintaining a balance between the internal and external stakeholders of corporations (Frankel & Li, 2004). In a transparent environment, stock prices are more likely to provide insightful previews of future events, thus reducing surprises in subsequent disclosures (Dasgupta et al., 2010). The role of audit committees is foundational in fostering an enriched informational milieu (Ghosh, 2019). While external audits focus predominantly on financial dimensions to serve owners and creditors, the objectives of internal audits are critical to bolstering the sustainability of financial reporting. Within this framework, sustainability accounting merges internal and external accounting practices to cover environmental, social, and economic aspects (Pistoni, et al., 2018). Furthermore, sustainability and corporate social responsibility encapsulate a firm's operations and mirror its societal and environmental impacts on stakeholders. Consequently, transparency and stakeholder communication should be strategically aligned with the principles of sustainability and corporate social responsibility (Lenssen et al., 2007).

Sustainability reporting encompasses nonfinancial facets of a company's performance not encompassed in the primary financial report. It offers stakeholders information about the company's actions concerning environmental, social, and governance issues that might impact their interests (Stolowy & Paugam, 2018; Stubbs & Higgins, 2018). Auditors have a substantial role in sustainability reporting, although questions may arise about the extent to which sustainability falls within their roles and responsibilities. These roles will be clarified in EU regulations.

In a few years, sustainability reporting will be an important part of entities' statements. Transparency is the key, and sustainability reporting expands the concept of stakeholders such as social partners, nongovernmental organizations, and environmental groups.

By publishing sustainability information along with financial information, entities provide a more comprehensive view

of their operations. This allows stakeholders to make informed decisions or follow up on issues about an entity's operations from both a financial and an environmental perspective.

Publishing sustainability information as standalone project does not reduce information asymmetry within the stakeholders, old and new ones, the assurance in a key factor here. (Cuadrado-Ballesteros et al., 2017). Significant concepts in financial auditing will get a new meaning, such as the expectation gap. The new stakeholders will have different expectations and it is the assurance process to balance it. (Harrer & Lehner, 2023). The assurance process of selecting sustainability issues and reporting will be a challenge for the audit profession. According to Boiral and Heras-Saizarbitoria (2020) sustainability reports in select industries did not have high quality, e.g. lack of credible verification.

The European Union has taken a leading role in promoting sustainability reporting with the implementation of the 2022 European Sustainable Reporting Standards (ESRS), which will help ensure that sustainability reporting is more consistent than earlier regulations or guidelines. Entities covered by the Corporate Sustainability Reporting Directive (CSRD), whether listed or not, must follow these sustainability standards. The implementation will take place in 2024–2026, and it will depend on company size.

The ESRS are focused on different sustainability areas, such as the environment, society, and governance. Each standard tackles specialized concepts—for example, climate change, pollution control, water management, and on marine resources. This is unlike the International Financial Reporting Standards (IFRS), which have the same focus regardless of entities.

Management regarding sustainability issues can augment stakeholder relations (Hörisch et al., 2014; Roberts, 1992). Transparency in sustainability efforts is a crucial factor. By openly reporting on these matters, entities can reduce information gaps (asymmetries)—thereby mitigating mistrust and conflicts of interest with stakeholders, such as investors, employees, and environmental groups (Shankman, 1999).

This paper explores how prepared auditors are, encompassing knowledge from a broader stakeholder perspective of sustainability accounting. Moreover, transparency is considered a key concept in sustainability accounting and dependable financial reporting. The research questions focus on auditors' knowledge regarding eight specific sustainability frameworks in force in 2022. Thus, knowledge regarding the frameworks could indicate auditors' readiness/preparation for environmental standards that the European Union has passed in the last few years.

2. Literature Review

2.1 *Credibility and Transparency*

Corporate governance becomes the focus of attention in corporate scandals (Velte, 2023). Hence, the response to financial scandals has been increased efforts by regulatory bodies to improve reliable financial accounting (Gunny & Zhang, 2013). Entity information is now both financial and environmental. Gatekeepers, such as external auditors, financial analysts, and audit committees, are under increasing pressure to monitor both perspectives. They play a critical role in safeguarding the credibility and transparency of financial reporting, promoting ethical business conduct, and ultimately, building trust with stakeholders (Bradley et al., 2017; Habib et al., 2021). Knowledge of sustainability reporting is the foundation for the “right” information in the disclosure. According to Vanini and Bochet (2024) there is a relatively low coverage of sustainability issues in select management accounting in textbooks, published in the period from 2010 to 2022. Recent studies have highlighted that ethical considerations and the credibility of sustainability reports are critical for maintaining trust and transparency (Aydemir, 2021).

2.2 *Sustainability Frameworks*

As the focus expands from purely financial reporting to sustainability, the market must be prepared. Organizations providing sustainability frameworks, guidelines, and recommendations have emerged through the years, e.g. Global Reporting Initiative [GRI], Sustainability Accounting Standards Board (SABS), and International Integrated Reporting Council (IIRC). These guidelines are often voluntary and therefore face legitimacy challenges. This has created sustainability reporting, making it difficult for companies to navigate and for stakeholders to compare information across entities. Achieving harmonization in sustainability reporting regulations remains a complex challenge due to the involvement of multiple actors with different agendas and priorities (Afolabi et al., 2022). The increasing adoption of green accounting principles underscores the need for standardized reporting to ensure data integrity and stakeholder engagement (Zik-rullahi & Jide, 2023).

2.3 *Risks and Opportunities*

Sustainability accounting takes a new direction in reporting compared to financial reporting, as its core objective is to identify, document, and assess environmental and social risks and opportunities. This allows entities to make more informed decisions that promote a sustainable future (Fagerström et al., 2016). The European Financial Reporting

Advisory Group (EFRAG) unveiled the preliminary drafts of the European Sustainability Reporting Standards (ESRS) in November 2022. These standards are set to become required for public interest entities across EU member states. The primary aim of sustainability accounting is to record and evaluate risks and opportunities within clearly defined sustainability domains (Fagerström et al., 2016). Nevertheless, existing research on sustainability accounting has largely overlooked assessment of the tangible sustainability benefits derived from corporate social and environmental activities (Afolabi et al., 2022).

2.4 Quality of Transparency

According to Bakarich et al. (2022), the audit profession faces a significant challenge in sustainability reporting. This challenge stems from a lack of preparedness, both in terms of knowledge and practical experience (Bakarich et al., 2022). Limited expertise of auditors concerning sustainability issues and reporting emphasizes the quality of transparency. This situation accentuates the critical function of auditors and audit committees in enhancing and sharing knowledge and trust across the interconnected spheres of financial and sustainability information (Adams & Abhayawansa, 2022). Such efforts are crucial for ensuring that sustainability reporting achieves its intended impact. Effective sustainability reporting requires auditors to develop specialized skills and experience in sustainability issues (Ascani et al., 2021).

2.5 Readiness for Change

The concept of readiness for change has its origins in early research on organizational change (Walinga, 2008). In the context of sustainability reporting and the accounting profession, a significant challenge lies in the prevailing assumption that accountants and financial professionals need to “be made ready” for the addition of sustainability reporting to their practices (Armenakis & Harris, 2002). Walinga (2008) highlights this challenge, suggesting that fostering readiness among accountants for sustainability reporting requires exploring how leaders in the accounting profession can get ready themselves to get auditors ready for this transformative change. The readiness to adopt sustainability reporting practices has emerged as a critical factor affecting the success or failure of sustainability reporting initiatives (Zayim, 2010). It revolves around auditors’ beliefs in their potential and efficacy to effectively incorporate sustainability considerations into their financial reporting processes.

2.6 Knowledge Gaps

Understanding how auditors perceive and adapt to sustainability reporting is essential for identifying knowledge gaps and experiential needs within the accounting profession. Addressing these gaps is crucial for effective sustainability accounting practices and promoting transparent and credible sustainability reporting (Bakarich et al., 2022; Al Amosh & Khatib, 2022). Recent studies emphasize the need for comprehensive education and training in sustainability issues for accounting professionals to bridge these gaps (Parkinson & Chew, 2022). An examination of how auditors perceive and adapt to the addition of sustainability considerations to their traditional financial reporting practices should provide valuable insights into the knowledge gaps and experiential needs within the accounting profession.

3. Method

Surveys serve as valuable instruments for both information gathering and measurement. The choice of this method is grounded in its cost-effectiveness and safety. By accessing and compiling information, this method facilitates knowledge generation through a transparent and logical analysis of the subject matter. The quantitative methodology chosen is particularly suitable when examining subjects that can be quantified, measured, or weighed, as it offers a standardized approach and can uncover patterns within the data.

3.1 Questionnaire

This study employed a quantitative research approach, utilizing a questionnaire-based survey as its primary data collection method. Participants were provided with the questionnaires via email, streamlining the process and encouraging survey participation.

The questionnaires are based on the same sustainability standards as those used in Bakarich et al.’s (2022) US survey. In that survey, the questionnaire focused on current experience and familiarity with sustainability reporting. In the Icelandic survey, the questionnaires only focused on knowledge (familiarity) of each sustainability standard, not experience.

Specific questions in the 2022 survey centered on eight sustainability frameworks, where the participants’ own perspective of their knowledge level regarding sustainability reports in financial statements and the extent of experience with handling sustainability reports were discussed. The participants were asked to answer the following questions:

Q1: “How do you rate your experience regarding experience/work with sustainability reporting when it comes to preparing and presenting financial statements?”

Q2: “How do you rate your knowledge regarding sustainability reporting?”

Q3: “How do you rate your knowledge regarding the following sustainability reporting framework standards?”

The study asked about eight sustainability principles and guidelines that were in force at the time of the study.

1. United Nations Sustainable Development Goals
2. Carbon Disclosure Project
3. Climate Disclosure Standards Board
4. GRI
5. International Integrated Reporting Council
6. Sustainability Accounting Standards Board
7. Task Force on Climate-Related Financial Disclosure
8. ESRS

Participants were asked to rate their own knowledge level regarding the eight standards on a five-point Likert scale (Warmbrod, 2014).

3.2 Iceland: Participants and Procedure

The survey was conducted in collaboration with the Association of Certified Public Accountants (ACPA) in Iceland. To ensure comprehensive participation, a request was extended to all auditors who were ACPA members, and the questionnaire was distributed to them. Using the QuestionPro software, the questionnaire was designed to gather information on perspectives regarding various concepts, including sustainability.

The questionnaire was sent to 430 ACPA members and garnered a response rate of approximately 20% from the target population, with a higher response rate of over 30% among auditors working in audit offices. Notably, around 60% of the respondents possessed over 16 years of experience as accountants, underscoring their significant expertise in the field.

The survey was conducted based on a predetermined time limit, from November to December 2022. The response rate is in line with international trends that indicate a certain fatigue with questionnaire surveys among participants (Fosnacht et al., 2017). Furthermore, studies have demonstrated that factors such as the issuer of the questionnaire, its length, and the timing affect the response rate (Fan & Yan, 2010).

4. Results and Discussions

The main findings of this survey are that accountants have limited knowledge of the eight sustainability frameworks. This might indicate a lack of knowledge to adhere to the new sustainability regulation by the European Union, for example. This is in line with the results of Bakarich et al.’s (2022) survey regarding American accountants.

In relation to experience (Q1), 3% of the participants answered that they had extensive experience. About 45% answered that they had little or very little experience with sustainability rules and guidelines. This could be a result of the nonmandatory audit requirement regarding sustainability reporting at the time of the survey. About 52% of the participants had limited experience—not much or little.

Concerning knowledge (Q2), 10% of participants reported possessing extensive knowledge regarding sustainability reporting, while 37% answered having little or very little knowledge. The outcomes suggest the presence of a minority with significant knowledge regarding sustainability accounting. About 10% of auditors demonstrated sound knowledge, while about 20% reported having limited knowledge and about 16% very little knowledge. Disclosure or information regarding sustainability issues has not been part of the auditing process of financial statements.

However, it is worth considering that the issue of low familiarity with sustainability accounting could be mitigated through collaborative audit efforts, where not all team members need to possess identical knowledge or experience levels. The audit team should have the knowledge needed to ensure audit quality; this is the audit team leader’s responsibility. If the issue in the questions lies outside of the mandatory audit process, it could therefore not be a priority regarding knowledge or experience within the audit process.

Table 1 shows that the average respondent’s knowledge of each sustainability framework (Q3) ranged from 1.710 to 2.032. The GRI, which has been in effect for almost 25 years, had the highest mean.

Table 1. Accountants’ Own Assessment of Knowledge About Eight Sustainability Frameworks in Iceland

	N	mean	std.dev.
Carbon Disclosure Project	62	1.758	0.776

Climate Disclosure Standards Boards	62	1.774	0.771
Global Reporting Initiative	62	2.032	0.920
International Integrated Reporting Council	62	1.710	0.791
Sustainability Accounting Standards Board	62	1.885	0.770
Task Force on Climate-Related Financial Disclosure	62	1.806	0.820
United Nations Sustainable Development Goals	62	1.903	0.837
European Sustainability Reporting Standards	62	1.952	0.831

Participants' responses concerning familiarity with sustainability reporting frameworks further underscore the limited knowledge in this realm. These results point to a low level of familiarity with various sustainability reporting frameworks. This could indicate that limited knowledge among accountants regarding sustainability frameworks is not a local phenomenon but a global one. According to Fernandez-Feijoo et al. (2016) the choice of provider among the Big4 depends on country and the industry. These findings gain heightened significance considering the implementation of mandatory sustainability reporting requirements.

This limited knowledge of an active sustainability framework does not ease the implementation of the new sustainability regulation from the European Union. The ESRS and related regulations will be implemented with a tight time frame and mandatory audit. The latest IFRS standard, 17, was issued in May 2017 and applied on January 1, 2023. It has been five years since it was issued, but in September 2004, the Insurance Working Groups were introduced, giving auditors a total of 18 years to prepare themselves. IFRS 17 replaced IFRS 4, implying it is not a new area of knowledge. Sustainability standards are a new area of knowledge for auditors. Despite that, the time given for legalization is shorter than that of the implementation of IFRS (2017) standards.

Collaborative teams (e.g., audit teams) play a vital role in sharing knowledge and experience, benefiting both theoretical understanding and practical application. The exchange of insights and experiences holds substantial importance in bolstering audit quality and facilitating accurate portrayals of financial statements. It seems a new knowledge structure is needed or is already being implemented in the audit profession. In response to the short time frame regarding the application of sustainability standards to financial statements, one avenue is enhancing knowledge and experience transfer within audit teams concerning sustainability matters. Another approach can involve increasing third-party assurance within the sustainability realm. According to Channuntapipat et al. (2020) there is a notable difference between accounting firms and non-accounting firms, on how the providers' approaches to sustainability assurance.

Auditing processes are constantly changing because operations and regulatory environments are never static. The same applies to knowledge. This indicates that knowledge management is under pressure due to the short notice of the implementation of sustainability and environmental standards. Auditors are now responsible for preparing and presenting sustainability reports along with financial statements. A special knowledge of nonfinancial information is now more important than ever. Audit thinking and professional judgment are now more in the spirit of a balanced scorecard than pure financial information. Professional judgment, both in attitude and mindset, must be upgraded because of the sustainability standards. This is some kind of paradigm shift in the audit world. In the next few years, knowledge management and transfer are likely to be top priorities in the audit process.

The outcome may guide toward the audit process itself, which indicates necessary adjustments to maintain audit quality as sustainability factors are integrated into a company's operations and its financial statements. Auditing of sustainability matters is not done by a single auditor; an audit team is involved, both locally and globally. The knowledge within the team should not have an equal distribution among individuals. The audit team leader now has an extraordinary responsibility to ensure that knowledge is available within the team in terms of sustainability standards to maintain audit quality, e.g., professional judgment and scepticism. The results may indicate that a greater demand should be made to the legislature that there be enough time to create knowledge about new legislation before it is implemented.

Sustainability information is nonfinancial information, and thus far, it has not had a good legal basis regarding creation, presentation, or review in terms of rules or guidelines for the sustainability of international organizations. In many cases, legal obligations have been quite limited. Therefore, there is a significant change in this respect with the introduction of the CSRD. For example, the Non-Financial Reporting Directive for companies to choose the information and focus, but in the CSRD, it is mandatory to follow certain sustainability standards (i.e., very little flexibility). Another important factor that distinguishes the two regulations is that there is no provision in the Non-Financial Reporting Directive for audit or assurance work, but it is mandatory in the CSRD.

It is expected that compliance with the CSRD and other EU sustainability regulations will be such that auditors or an independent third party can review and/or confirm information on the preparation and presentation of sustainability reports. The CSRD entered into force in January 2023; it is a framework that addresses the legal obligation of companies to apply sustainability standards. The ESRS are the standards for enforcing the obligations set out in the CSRD. The ESRS is then divided into four categories. A category that generally deals with conditions and information as well as the companies' obligation to explain. Here, there are three subcategories: environment (environmental), marked with "E"; society (social), marked with "S"; and governance, marked with "G" (Directive 2022/2464).

There is a difference between the ESRS and the IFRS. The ESRS applies to a certain economic activity as well as its environment, depending on whether the operation is related to water use, polluting activities, mining, or biotechnology. Each ESRS standard covers specialized terms, such as climate change, pollution, water, and marine resources. Integration of the ESRS with the IFRS may facilitate the implementation of the standards (Directive 2022/2464).

5. Conclusion

This study explores one of the most important topics that auditing professionals have been confronted with over the last few years: nonfinancial reporting. In the European Union, the legislative action (which is also implemented in Iceland) in this field mandates a growing number of enterprises to disclose nonfinancial information. This implies the increasing importance of nonfinancial disclosure by auditors in this field.

The result of this study contributes to the literature on sustainability reporting by providing evidence of limited knowledge among the Icelandic auditors who participated in the survey. This evidence supports conclusions from a similar survey by Bakarich et al. (2022) in the United States. Auditors, internationally, can have a major role in developing sustainability reporting due to their profession. Common to both surveys are that most of the professional auditors who participated were not familiar with the current sustainability framework.

This situation raises significant concerns, especially given the impending regulatory requirements in Iceland, such as Directive (EU) 2022/2464, which amends Regulation (EU) 537/2014. A possible explanation for the result could be that the implementation time frame is too narrow. There has been insufficient time for auditors to familiarize themselves with the content of the sustainability standards. These results are critical, as mandatory sustainability standards are currently due internationally.

This study may indicate that the individual auditor may not be ready for the pivotal change driven by sustainability reporting. Accounting firms can have sustainability reporting teams rather than preparing all individual auditors. The introduction of special units or teams focused on sustainability reporting could be an approach for managing knowledge within the audit profession. A knowledge structure hierarchy can be part of the solution.

A systematic failure of governments and regulatory institutions could limit the implementation of sustainability reporting locally and even globally. Whatever the reason for the lack of readiness of auditors and potentially related actors, such as accounting committees and boards of directors of firms, it will affect the quality of sustainability reporting. To view it from the perspective of corporate governance agency theory, the lack of knowledge implies there could be a system failure within the corporate governance of firms when auditors, important gatekeepers within the system, are not supporting the implementation of sustainability reporting with a high knowledge level. This can affect the knowledge transfer between auditors and audit committees, who are gatekeepers as well, and boards of directors. In terms of asymmetric information, this would create a new problem as the gatekeepers, the audit profession, and audit committees would lack the relevant knowledge and possible experience to ensure sufficient accuracy and transparency in financial reporting, which includes sustainability reporting.

The results of this study indicate that the audit profession has work to do regarding sustainability reporting to get ready for this looming change. This means providing opportunities for employees to acquire knowledge, organize knowledge management, and transfer knowledge within the profession. Knowledge transfer within the audit profession could be the biggest challenge for the next few years.

As financial and sustainability reporting converge, auditors will undoubtedly play a central role in this transformative process. However, the specific roles and responsibilities of audit committees within this evolving landscape need a clear definition. To ensure transparency is not compromised, all key stakeholders must fully understand the crucial function of audit committees in this overhaul.

This study utilized a survey-based approach, which provides valuable insights. However, future research could significantly enrich the discussion by incorporating qualitative interviews. Exploring the perspectives and practices of auditors, especially within audit teams, could offer a deeper understanding of their roles, knowledge, and experiences related to sustainability reporting. Similarly, further research could focus on audit firms, which are likely to be pivotal in acquiring expertise in these new practices.

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Authors contributions

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