
Are the Companies Prepared for Sustainability Reporting under the ED IFRS S1 and S2? Evidence from Poland

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Abstract

This article aimed to determine the implications of the Exposure Drafts (ED) IFRS S1 and S2, especially for financial reporting. The novelty of these sustainability standards is the attempt to regulate sustainability and climate-related financial information. Therefore, the article first presents the key aspects of the ED IFRS S1 and S2, and their practical implications. As both EDs represent an ambitious proposal of standard-setters, the author attempted to determine whether companies in Poland are prepared for these changes. For this reason, the EDs were confronted with (1) Poland's legal and soft sustainability regulations, and (2) empirical research results. An empirical part was performed based on the selection of 177 companies, listed on the Warsaw Stock Exchange (WSE). The evidence represents the collection of their responses to the selected ESG sections of "The Best Practice 2021" WSE Code.

The study provides numerous conclusions and observations. ESG undoubtedly became a factor considered by multiple companies in their businesses. However, preparing for the ED IFRS S1 and S2 means a complete ESG integration into a business strategy, processes, and reporting. Only sixty companies (34%) in the examined sample declare ESG integration into a business strategy, and thirty-two companies (18%) claim they disclose the strategic data, including defined goals, measures, and progress (also ESG-related). Considering the progress of the ESG revolution, it will mean reporting transformation for most companies, i.e., building sustainability-related financial reporting from scratch. The biggest challenge will be quantifying the impact of sustainability and climate-related risks and opportunities on financial statements. Such quantification will require advanced risk management tools and the building of an integrated reporting system. The article, with its findings, may be of high interest to standard-setters, companies, and other researchers contributing to ESG and financial reporting.

Key Words: ESG; financial statements; sustainability reporting; IFRS S1; IFRS S2;

JEL Classification: M48, K2, Q56

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Introduction

Sustainability reporting is a topic that nowadays receives intense attention. It aims to provide a non-financial statement that assures the general public that the company's operations are fair, reasonable, and credible. However, it is insufficient to inform the general public that a company respects the surrounding environment and society. The current trend in sustainability reporting is to provide measurable and comparable information which proves the statement. Measurement of non-financial information is challenging as it raises questions about what to measure and how. It becomes even more complicated if we attempt to express the impact of non-financial factors in financial terms. Thus, it is worth exploring this topic in light of recent proposals promoted by regulators and standard-setters.

Sustainability reporting is usually discussed from the perspective of values that this reporting creates, for example: (1) it acts as a communication channel about the benefits that the company creates for society (cf. Herzig, Schaltegger, 2006), (2) it promotes greater transparency which should result in improved credibility; hence, it brings reputational benefits (cf. Kolk, 2004), or (3) may be correlated with particular corporate characteristics like board gender diversity (cf. Al-Shaer & Zaman, 2016), location, profit margin, and growth rate (cf. Dilling, 2010).

In many cases, sustainability reporting is associated with the reporting of environmental footprints, but it should be underlined that the whole concept is much broader. In terms of corporate social responsibility (CSR), the standard ISO 26000 distinguishes seven critical areas, which are: (1) organizational governance, (2) human rights, (3) labour practices, (4) the environment, (5) fair operating practices, (6) consumer issues, and (7) community involvement and development (ISO 26000:2010, p.9). The same relates to the reporting of ESG, which stands for Environmental matters, Social matters, and Corporate governance.

Sustainability reporting is often used interchangeably with non-financial, CSR, and ESG reporting. For sure, all of them are similar in making businesses accountable for the consequences in a comprehensive view: not only for the financial ones, but also for those related to, e.g., climate change, carbon emissions, water pollution, human rights, labour standards, and corporate governance.

However, there are subtle differences between each reporting type. 'Non-financial reporting' is a term mainly

used in the context of mandatory reporting requirements imposed, for example, by the Non-Financial Reporting Directive (discussed later in this article).

On the other hand, CSR reporting is perceived as a form of soft law which is voluntary, but strongly desirable. Generally, it may act as a communication channel and support decision-making for different stakeholders (cf. Moravcikova, Stefanikova, & Rypakova, 2015). Value-driven CSR should correspond to corporate responsibility, transparency, and an ethical mindset (cf. Tan, 2013). However, it is challenging to ensure comparability between CSR reports as different factors may shape their scope, including differences in developed and developing countries (cf. Ali, Frynas, & Mahmood, 2017).

It is commonly stated that CSR reporting makes businesses socially accountable, whereas ESG focuses on a practical measurement and an integrated business strategy. Some observers even talk about the evolution from vague CSR to more specific ESG. Such reasoning is justified if we consider many aspects of ESG, such as ESG standards and frameworks, ESG investing, ESG scores, or ESG assurance (cf. Indyk, 2022).

One of the main challenges ESG faces is to ensure meaningful and measurable reporting. For this reason, various organizations attempt to standardize ESG disclosures (e.g., the Global Reporting Initiative, the Task Force on Climate-related Financial Disclosures, Streamlined Energy, and Carbon Reporting). However, from the financial reporting perspective, the critical question is about the economic consequences of ESG activities.

Thus, the International Sustainability Standards Board (ISSB) has proposed two Exposure Drafts: IFRS S1 – *General Requirements for Disclosure of Sustainability-related Financial Information* and IFRS S2 – *Climate-related Disclosures*. Both Exposure Drafts are risk-based, meaning that a reporting entity should disclose its exposure to significant sustainability and climate-related risks and opportunities, followed by how these risks and opportunities have affected the most recently reported financial position, financial performance, and cash flows (ED IFRS S1, pp.22-27; ED IFRS S2, pp. 32-37).

The Exposure Drafts mentioned above will mean particular reporting requirements, which raises multiple potential questions about: (1) the reporting entities in scope; (2) a separate reporting system; (3) linkages with a financial statement and potential integration with financial

reporting; (4) the role of auditors; and (5) possible overlapping with existing accounting and sustainable-related reporting requirements. For this reason, the central hypothesis of this article is formulated as follows:

[H] The sustainability standards IFRS S1 and IFRS S2 will lead to meaningful changes in financial reporting.

To verify the hypothesis, I proposed both theoretical and empirical parts. The theoretical part includes an analysis of the critical aspects of the ED IFRS S1 and S2 (Sections 1-2) and a comparison with Poland's legal and soft regulations regarding sustainability reporting (Section 3). The empirical part has been presented in Sections 4-5. I selected 177 companies, listed on the Warsaw Stock Exchange (WSE), and collected their responses to the ESG sections of "The Best Practice 2021" WSE Code. Finally, Section 6 presents Conclusions, whereas Section 7 - Discussions.

Both ED IFRS S1 and S2 are risk-based, meaning they assume identification of the sustainability- and climate-related risks and opportunities, followed by assessing their impact on a business model, strategy, and financial results in the short, medium, and long term. In reality, it is not all about disclosure requirements but, most importantly, about business organization changes, such as solid ESG risk management, appropriate reporting system, policies, and procedures. Both EDs are part of the current sustainability trend, represented by initiatives like the Corporate Sustainability Reporting Directive (CSRD) proposal or standards promoted by the European Financial Reporting Advisory Group (EFRAG).

ESG undoubtedly became a factor considered by multiple companies. In many cases, it has been proved that we are talking about meaningful and value-driven activities. However, ESG often seems to be additional to the core business. Only sixty companies (34%) declare ESG integration into a business strategy, and thirty-two companies (18%) claim they disclose the strategic data, including defined goals, measures, and progress (also ESG-related). It may be concluded that these groups are ready to consider and implement the proposals of the ED IFRS S1 and S2.

Other groups represent different attitudes toward ESG matters. Some companies do not have a formalized strategy in this aspect, but they are highly involved in various ESG activities. On the contrary, a group of companies may be classified as ESG-neutral. Some companies declare a minor climate impact due to (1) a

size or a business type, (2) exemption from the non-financial reporting under the Non-Financial Reporting Directive (NFRD), or (3) other priorities, such as financial difficulties. Moreover, multiple companies are reluctant to disclose sensitive, strategic or competition-related information.

Finally, the ED IFRS S1 and S2 will lead to meaningful changes in financial reporting. Considering the progress of the ESG revolution, it will mean reporting transformation for most companies, i.e., building sustainability-related financial reporting from scratch. The biggest challenge will be quantifying the impact of sustainability and climate-related risks and opportunities on financial statements. Such quantification will require advanced risk management tools and the building of an integrated reporting system.

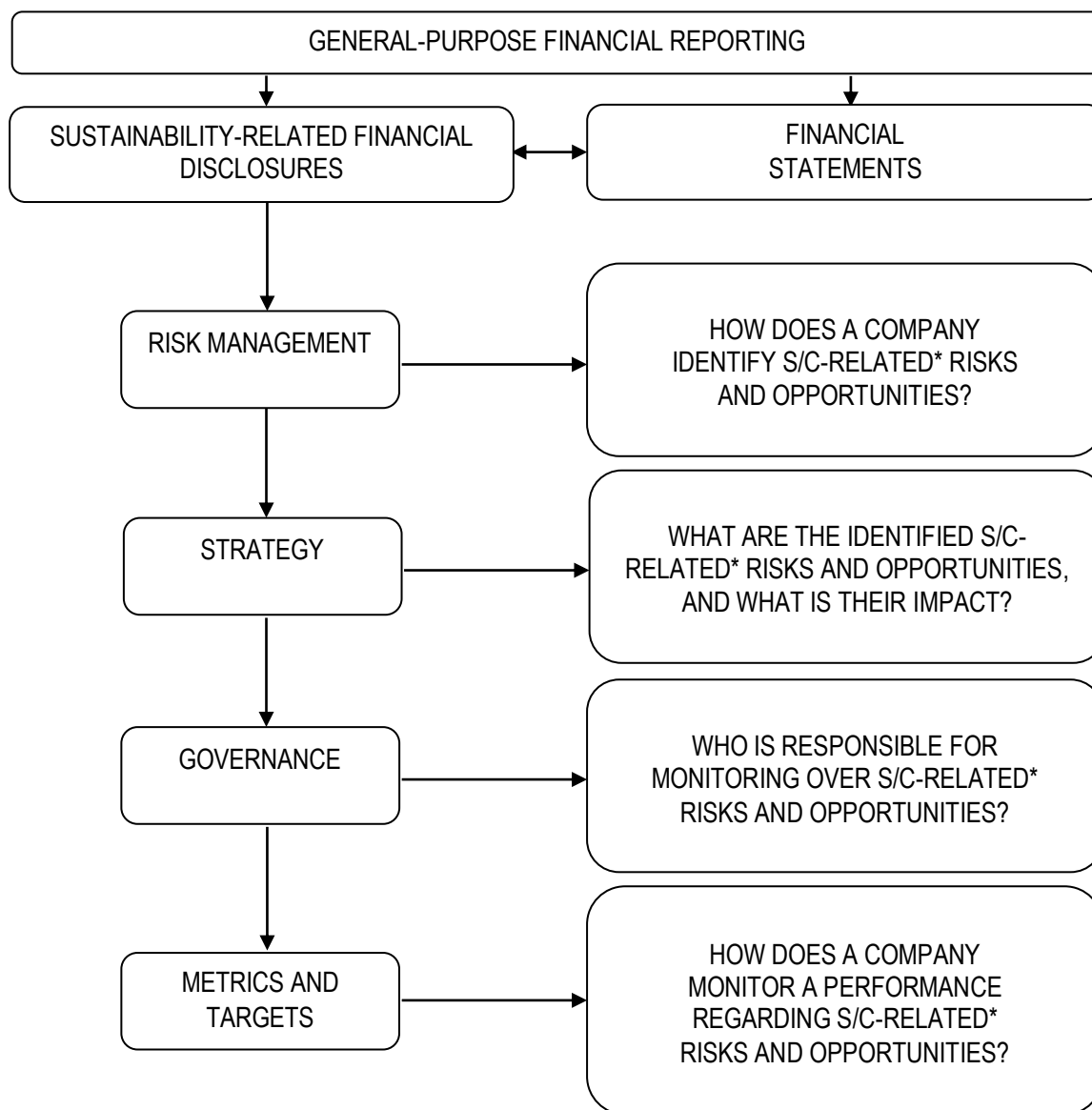
1. The critical aspects of the ED IFRS S1 and S2

The International Sustainability Standards Board (ISSB) issued its first two Exposure Drafts (ED), IFRS S1 and S2, in March 2022. Both Drafts were open for comments by 29 July 2022, and their final version will evolve. However, considering work progress, it is worth investigating the critical aspects of the ED IFRS S1 and S2 in their current form, i.e., as of August 2022.

The ED IFRS S1 and S2 will be essential milestones in sustainability reporting as they address sustainability and climate-related financial information. Such information may be crucial for various stakeholders interested in a better assessment of an enterprises' value and looking for other reasonable arguments in making decisions. The idea behind the standards is to create a combination of financial statements and sustainability-related financial disclosures, contributing to the so-called general-purpose financial reporting.

According to the ED IFRS S1 and S2, sustainability and climate-related financial disclosures should focus on four vital areas (*Figure no. 1*). The first disclosure relates to "Risk Management", which means disclosing the processes which are designed and implemented in a company to (1) identify sustainability- and climate-related risks and opportunities, (2) assess their likelihood and potential effects, and (3) prioritize the most important ones relative to other types of risks and opportunities (cf. ED IFRS S1, p.28; ED IFRS S2, p.39).

Figure no. 1. The critical aspects of the ED IFRS S1 and S2



*S/C-RELATED – Sustainability and Climate-related
 Source: Own elaboration, 2022

The second step is to reveal a “Strategy”, which means disclosing the identified sustainability and climate-related risks and opportunities and their expected impact on a business model, strategy, and financial results in the short, medium, and long term. In a nutshell, a reporting entity should reveal how these risks and opportunities have affected the most recently reported financial statements and how the figures are expected to change

over time (cf. ED IFRS S1, pp. 25-27; ED IFRS S2, pp. 33-37).

The third reporting area is “Governance”, which focuses on dedicated bodies or individuals and their responsibility to monitor sustainability-related risks and opportunities. They should consider at the same time the entity’s strategy, risk management, and other managerial activities (cf. ED IFRS S1, p.24; ED IFRS S2, p.32).

Finally, the fourth area is devoted to “Metrics and Targets”. While the previous disclosures were mainly narrative, this one relates to the selection of particular targets and measurable indicators which should reflect the entity’s performance in terms of a business model, a strategy, and identified sustainability-related risks and opportunities. It should be noticed here that climate-related risks and opportunities are specific. The ED IFRS S2 refers, for example, to greenhouse gas emissions, vulnerability to transition and physical risks, or internal carbon prices (cf. ED IFRS S1, pp. 29-30; ED IFRS S2, pp. 40-43).

2. The implications of the ED IFRS S1 and S2 for companies and auditors

Both Exposure Drafts were open for comments by 29 July 2022, and the ISSB received 731 responses and suggestions. The ISSB published comment letters (CL) from various companies, financial institutions, universities, accounting, and consulting firms, and individuals on its website. It is worth considering a few of them to anticipate how the Standards will evolve and what consequences they may bring. In general, the Exposure Drafts were strongly welcomed and supported by commentators. However, there are areas that were repeatedly mentioned for reconsideration.

Firstly, the standard-setters were asked for more clarification. They attempted to be general and flexible enough, but the Exposure Drafts lack precision, especially regarding:

- the integration with the existing IFRS Accounting Standards and Conceptual Framework for Financial Reporting (cf. EY CL);
- ambiguous terms like “Materiality”, which is currently determined by selecting “significant” risks and opportunities, or “Value Chain”, which may have various interpretations in a business model (cf. Deloitte CL);
- the industry-based approach to sustainability-related matters, especially in the case of companies operating in multiple industries and geographies (cf. Shell International CL);
- not mandating a specific location for the disclosures (such as a separate sustainability-related report); otherwise, sustainability-related information may be

published anywhere or just spread across a financial statement (cf. EY CL);

- the proper interpretation of climate-related disclosures, transition plans, and carbon offsets (cf. Deutsches Aktieninstitut CL).

Secondly, it should be underlined that the proposed disclosures will be challenging for many entities. They may not have the knowledge, methodology, systems, processes, data, and human resources to (1) report sustainability and climate-related information based on the risk assessment, and (2) integrate this information with financial reporting (cf. EY CL). As pointed out in AICPA & CIMA CL, sustainability risks can be more challenging to quantify than traditional risks. Therefore, organizations must ensure that sound risk management procedures are in place. On top of that, there should be an adequate balance between the need for greater transparency and the level of detail, also considering other material business risks and opportunities. Entities shall not be forced to disclose sensitive information that might lead to a competitive disadvantage (cf. Deutsches Aktieninstitut CL).

Considering all the above, the proposed timing of the sustainability-related financial disclosures (i.e., the same as financial statements) is currently strongly criticized. A publication of a financial report takes place based on robust and long-established processes, including dedicated IT systems. Requiring the exact timing for sustainability reporting will put unnecessary pressure on companies, may generate additional costs, and be detrimental to the quality of the disclosures (cf. Schneider Electric CL).

Finally, the Exposure Drafts do not consider the role of auditors whose contribution is perceived as valuable. Auditors currently perform assurance engagements over ESG information. Like financial statement audits, third-party assurance may enhance the reliability of ESG information. However, the starting point is a well-defined standard, which should act as guidelines for both entities and auditors. Obtaining any level of assurance involves evaluating particular processes, systems, and data in place (cf. CAQ CL, AICPA & CIMA CL, Aviva CL).

3. Legal requirements and soft regulations regarding sustainability reporting in Poland

The proposals of the ED IFRS S1 and S2 seem to be revolutionary. It is worth considering whether these proposals might be compared to similar solutions in

practice. Considering Poland's example, the general concept of sustainability reporting is not new. First of all, Poland, as a member state of the European Union (EU), must comply with the legal requirements imposed at the EU level. In 2014, the EU regulators enacted the EU Directive 2014/95/EU, called the Non-Financial Reporting Directive (NFRD). The Directive imposes an obligation of non-financial reporting for public-interest entities (i.e., listed companies, banks, insurance companies, and other companies designated by national authorities as public-interest entities) which meet a criterion of 500 employees.

According to Articles 19a and 29a of the NFRD, a non-financial statement (both at statutory and group levels) should include a brief description of a) a business model, b) implemented policies, c) the outcome of those policies, and d) the principal risks which may affect business operations. A non-financial statement should be supported by non-financial key performance indicators relevant to the particular business. Non-financial reporting should address environmental matters, social matters, human rights, anti-corruption activities, and diversity on company boards.

The enacted Directive was vital in discussing non-financial reporting and its outcomes. Its aim was to: (1) establish minimum legal reporting requirements, (2) enhance the consistency and comparability of non-financial information, (3) ensure investors' access to non-financial information, and (4) consider non-financial information from the perspective of risks which may affect business activity (cf. NFRD, 2014, pp. 1-4).

However, the NFRD faced criticism. The Directive contains several vague wordings (e.g., in terms of key performance indicators or materiality), which leads to the company's subjective assessment and, *de facto*, not enough relevant information disclosed to stakeholders. Ultimately, it raised the question of data comparability and reliability (cf. Björklund, 2021).

The regulators considered these practical drawbacks, and the NFRD will evolve into the Corporate Sustainability Reporting Directive (CSRD). The current proposal, which will become effective for financial years starting 1st of January, 2023, extends the scope to all large and listed companies (except listed micro-cap). Moreover, the range of sustainability reporting will be broader and, according to the replaced Article 19a, will include an extended descriptive part. A reporting entity will have to describe briefly, i.a., the resilience of the undertaking's business model, the opportunities related to sustainability matters, how the strategy concerning sustainability matters has been implemented, the role of the dedicated administrative, management, and supervisory bodies, and the targets about

sustainability matters. The descriptive part should be supported by qualitative and quantitative information, both forward-looking and retrospective information, with references to the management report and the annual financial statements, where appropriate. The CSRD proposal also requires obtaining the assurance of reported data from an independent assurance services provider.

To support sufficient sustainability disclosures in line with the CSRD requirements, the European Financial Reporting Advisory Group (EFRAG) works on reporting standardization. As of August 2022, the EFRAG closed its public consultation on the Exposure Drafts of the European Sustainability Reporting Standards (ESRS). The ESRS architecture consists of: (1) cross-cutting standards (ESRS 1-ESRS 5), which cover the general provisions applying to sustainability reporting under the CSRD and the ESRS; (2) topical standards related to three areas: Environment (ESRS E1-E5), Social (ESRS S1-S7), and Governance (ESRS G1-G3); and (3) sector-specific standards to be drafted in stage 2.

Finally, regarding soft regulations in Poland, the Best Practice 2021 for the companies listed on the Warsaw Stock Exchange (the Main Market) is worth mentioning here. The document came into force on 1 July 2021. Generally, it represents corporate governance disclosure requirements with the 'comply or explain' approach. It means that the companies must comment on whether they comply with the corporate governance rules or provide exhaustive justification if not. Among different requirements, the first section, 'Disclosure Policy, Investor communications', addresses ESG matters (the Best Practice, 2021, p.3).

In conclusion, sustainability reporting is a concept in Poland that evolves in line with the proposals raised by different standard-setters, especially in the EU. There are visible similarities between the ED IFRS S1 and S2 and the CRSD proposal. Despite the general applause for these initiatives, they also face criticism (as presented in Section 2) and lead to other questions, for example, about mandatory assurance engagements mentioned in the CSRD proposal (cf. Accountancy Europe, 2022). In all, financial reporting will experience the ESG revolution. The pace of progress is enormous, and the scope of requirements is substantial as it is not all about disclosures but about changes in the business organizations (e.g., to ensure sound risk management). In the end, it means significant investment, involving expenditures, time, talented human resources, and building an integrated reporting system supported by a reporting methodology, policies and procedures. In the turbulent times we live in, the question is whether companies are ready to adapt to these rapid changes.

4. The empirical research methodology

To investigate whether companies are prepared for the ESG reporting revolution and the changes it may bring, I decided to analyze companies' responses to ESG matters included in "The Best Practice 2021", i.e., the Code of Corporate Governance for companies listed on the Warsaw Stock Exchange (WSE) the Main Market. The Code addresses ESG matters in Section 1.3. and 1.4. as follows (the Best Practice, 2021, p.3):

"1.3. Companies integrate ESG factors in their business strategy, including in particular:

1.3.1. environmental factors, including measures and risks relating to climate change and sustainable development;

1.3.2. social and employee factors, including, among others, actions taken and planned to ensure equal treatment of women and men, decent working conditions, respect for employees' rights, dialogue with local communities, and customer relations.

1.4. (...) companies publish on their website information concerning the framework of the strategy, and measurable goals, including, in particular, long-term goals, planned activities, and their status, defined by measures, both financial and non-financial. ESG information concerning the strategy should, among others:

1.4.1. explain how the decision-making processes of the company and its group members integrate climate change, including the resulting risks;

1.4.2. present the equal pay index for employees (...)."

Compliance with the Code is voluntary. Nevertheless, the companies must disclose whether they comply with the principles or not (together with the justification why). It is not only about compliance but also about the companies' comments which, in many cases, demonstrate companies' attitudes toward ESG matters.

As of August 2022, there were 419 companies listed on the Main Market of the WSE. To ensure the proper selection and balance, I decided to select the companies which represent:

- Group A – the riskiest sectors according to the ESG Risk Atlas (2019, p.3): Oil and Gas, Metals and Mining (Risk Score 11), Power Generation (coal) (Risk Score 10), Refining and Marketing, Chemicals (Risk Score 9), Technology Hardware and Semiconductor, Power Generation (excl. coal), Autos and Auto Parts, Agribusiness and Commodity Foods (Risk Score 8);
- Group B – innovative sectors such as: Biotechnology, Land and Water engineering, New Technologies, Recycling, and Renewable Energy;
- Group C – other potentially related: Paper and Packages, Plastics, Construction, Construction Materials, IT Software, IT systems.

The final sample included 177 companies, as presented in **Table no. 1**. For these companies, I collected responses from their Compliance Statements, particularly from sections 1.3.1, 1.4., and 1.4.1. of "The Best Practice 2021" Code. I did not consider the social and employee factors as they were not crucial for this article.

Table no. 1. The structure of selected sample	
Sector	No. of companies
Group A	
Agribusiness and Commodity Foods	17
Automotive and Transport	14
Chemicals	12
Metals and Mining	23
Oil and Gas	2
Power Generation	9
Technology Hardware and Semiconductor	9
Group B	
Biotechnology	10
Land and Water engineering	6
New Technologies	3
Recycling	4
Renewable energy	3

Sector	No. of companies
Group C	
Construction	19
Construction materials	15
IT Software	17
IT Systems	9
Plastics	3
Paper and Packages	2
Grand Total	177

Source: Own elaboration, 2022

5. The empirical research results

5.1. Integrating ESG factors into a business strategy (Principle 1.3.1.)

Based on the collected evidence, sixty companies (34%) declare that they entirely apply Principle 1.3.1, i.e., the integration of ESG factors into a business strategy, particularly those related to climate change and sustainable development. Regarding sector specification, forty companies belong to group A, five to Group B, and fifteen to Group C. Six companies provide additional explanations for particular

ESG-related decisions and actions, for example, a long-term strategy by 2030, a focus on renewable energy sources, environmental management confirmed by ISO 14001:2004, ecological policies, training, pro-ecological initiatives, recycling, or cooperation with local communities and customers.

Forty-six companies (26%) comply partially with the Principle. Even though they do not have a formalized business strategy that includes ESG goals and measures, they are highly involved in various meaningful ESG activities specific to their sector (Table no. 2).

Table no. 2. Examples of sector-related ESG activities

Sector	Examples
Group A	
Agribusiness and Commodity Foods	Monitoring of the generated air pollution, water intake, and energy consumption; quantitative and qualitative records of waste turnover; dedicated environmental protection section; an Integrated Management System which combines quality with ecological protection; certification regarding Global Standard for Food Safety; installation of photovoltaic panels; reduction in the use of preservatives and palm oil; ensuring that fish are from sustainable fisheries.
Automotive and Transport	Ecological solutions for cars and looking for alternative energy sources; monitoring the company's environmental impact by taking measurements and analyzing the results above its limits; monitoring ecological metrics, including energy intensity and consumption of energy utilities; using air protection equipment; tailored specifications, policies, procedures, and instructions.
Chemicals	Reduction in emissions of pollutants and greenhouse gases; investment in environmentally friendly technologies; development of low-emission and biodegradable products; involvement in hydrogen projects; waste management; Integrated Management System (IMS) certified by the Polish Centre for Testing and Certification.
Metals and Mining	Compliance with system standards (quality, environment, health and safety, and energy management); compliance with industry standards for the district heating, gas, water and sewerage, and construction sectors; environmental policy; climate policy; dedicated sustainability strategy.
Biotechnology	The search for technologies related to the reuse of waste materials from various industries; technology used for the reclamation of contaminated land; technology to process waste hydrogen and reuse it as a fuel to generate energy.
Power Generation	Measures to change the primary power source of the CHP plant to a low- or zero-emission source; an energy transformation project.
Technology Hardware and Semiconductor	Certification ISO 14001 (environmental management); Certification ISO 50001 (energy management); separate pro-ecological foundation.

Sector	Examples
Group B	
Land and Water engineering	Certification ISO 14001 (environmental management); environmental policy; documented procedures for identifying and evaluating ecological aspects; operational control and monitoring of environmental activities; waste management; handling of substances hazardous to the environment; ensuring compliance with legal requirements; recording the fuels, materials used or factors causing emissions into the air; testing and measurement.
Plastics	Certification ISO 14001 (environmental management); introducing new technologies; reducing material consumption; implementing secondary materials in production; reducing waste generation; recycling of technological surpluses in a closed production process; transfer of waste generated from operations to specialized business units.
Recycling	Transforming a nuisance waste into a high quality, easily degradable product; optimization of the resources used (electricity, material consumption).
Group C	
Construction	Certification ISO 9001 (quality management systems); Certification ISO 14001 (environmental management); Certification ISO 45001 (safety management); modern technological solutions; environmentally friendly measures; investments in renewable energy sources; construction services in the area of renewable (wind) energy.
Construction materials	Optimizing the use of resources and the environment; participation in the renovation of rail transport infrastructure; investments based on renewable energy sources; due diligence policies or procedures dealing with social, labour, environmental, human rights, and anti-corruption issues; reduction of pollutants emitted to the air; protection of water and soil; monitoring and recording of utility consumption, emissions, waste generated and packaging put into circulation; water saving; looking for emission-free heat sources; achieving the highest possible energy efficiency for new products; usage of photovoltaic solutions.
IT Software	Installation of photovoltaic panels; encouraging employees to use bicycle transport; waste segregation; training; considering reputation and approach to environmental issues in selecting business partners and suppliers.
IT Systems	Certification ISO 14001 (environmental management); reducing fuel consumption and water demand; using alternative energy sources; implementing and certified quality management system; developing and implementing modern information technologies that use environmentally friendly solutions.

Source: Own elaboration, based on the collected evidence, 2022

Twenty-eight companies (16%) may be classified as at a planning stage, as they declared future consideration of ESG matters in a formalized business strategy. Thirteen companies (7%) did not apply the Principle due to other business priorities, such as dealing with financial difficulties or, conversely, with other strategic investment opportunities. Twenty-five companies (14%) assessed their environmental impact as insignificant. These companies characterize themselves as non-manufacturing, office-based, or administrative businesses with a minor effect on climate. Five companies (3%) were not obliged to publish non-financial information under the NFRD; therefore, they felt excluded from the discussion about ESG.

5.2. Disclosure of strategic information, measurable goals, planned activities, financial and non-financial measures, and ESG (Principle 1.4. and 1.4.1)

Principles 1.4. and 1.4.1. are problematic as they include multiple requirements: (1) disclosure of a business strategy, (2) defined goals, measures, and progress, and

(3) ESG, especially climate-related aspects. It led to different attitudes toward these Principles, depending on practices existing in a company.

Thirty-two companies (18%) declare they entirely comply with both Principles. Five companies provided additional information about particular actions and decisions, such as:

- monitoring of the regulatory environment (Legal Department) and regular analysis of packaging, energy and raw material prices (Purchasing Department);
- verification and identification of risks arising from external and internal factors twice a year, together with an analysis of the likelihood of their occurrence and possible impact on the company, followed by the preventive or mitigating actions for individual risks;
- several steps to build a modern sustainability management system within the company. The company's approach to implementing Sustainability into its business strategy was described in the ESG Strategy and Sustainability Report 2021, together with critical pillars, targets, and metrics;

- publication of a long-term strategy by 2030;
- publication of detailed information on the assumptions of its strategy, the measurable objectives, including long-term goals, the planned activities, the progress in its implementation, and metrics (financial and non-financial) in the management reports and the annual financial statements;
- certification ISO 14001 (environmental management); a certified auditor confirms the compliance of this certification.

Twenty-six companies (15%) make their strategy public. Still, in most cases, they do not consider ESG matters formally; however, they will or are in the progress of revising and implementing new strategic objectives, including ESG. Similarly, in their comments, twenty-two companies (12%) focus on their plans to develop a new business strategy or documents that consider ESG themes.

Twenty-eight companies (16%) do not publish details regarding their long-term strategy on their websites. As explained, it happens due to the nature of their businesses, the protection of sensitive data, and their competitive position.

Sixteen companies (9%) have not adopted a document constituting a long-term strategy. They usually set annual financial targets, whereas the measures for achieving them are determined annually in the company's budget plan.

Twenty-nine companies (16%) declare their communication with stakeholders regarding strategy and achievements through current and periodic reports. Some companies refer to non-financial reporting under the NFRD regarding ESG matters.

Twenty-four companies (14%) may be classified as ESG-neutral. Some declare a minor climate impact due to a size or a business type. The same relates to entities that are not obliged to publish non-financial information under the NFRD. Some companies were not involved in ESG matters due to other priorities, such as financial difficulties.

6. Conclusions

This article aimed to verify whether the companies in Poland are prepared for changes resulting from new sustainability standards. The author formulated the following hypothesis: *[H] The sustainability standards IFRS S1 and IFRS S2 will lead to meaningful changes in financial reporting.* The article consists of a theoretical part (sections 1-3) and a research study (sections 4-5) to verify this hypothesis. As of July-August 2022, both standards

were not formally implemented and represented the Exposure Drafts (ED) for public consultations.

The idea behind the ED IFRS S1 and S2 is to create a combination of financial statements and sustainability and climate-related financial disclosures, contributing to the so-called general-purpose financial reporting. Both EDs are risk-based, meaning they assume identification of the sustainability- and climate-related risks and opportunities followed by assessing their impact on a business model, strategy, and financial results in the short, medium, and long term.

In reality, it is not all about disclosure requirements but, most importantly, about business organization changes. Traditional financial reporting is a workflow with an accounting system, double-entry bookkeeping, supporting documentation, reporting standards, financial statements, and multiple procedures and policies. To identify and quantify the effects of the sustainability and climate-related risks and opportunities, the companies must ensure they have a similar workflow for sustainability reporting (not to mention very demanding risk assessment). In the end, it means significant investment, involving expenditures, time, talented human resources, and building an integrated reporting system supported by a reporting methodology, policies, and procedures.

Both EDs are part of the current sustainability trend, represented by initiatives like the Corporate Sustainability Reporting Directive (CSRD) proposal, or standards promoted by the European Financial Reporting Advisory Group (EFRAG). As they represent the EU initiatives, these proposals also relate to Poland.

Therefore, considering all the above-mentioned theoretical discussions, the author decided to confront the theoretical assumptions with reality based on the companies' experience in Poland. The empirical research focused on the responses to ESG principles included in "The Best Practice 2021", i.e., the Code of Corporate Governance for companies listed on the Warsaw Stock Exchange (WSE) (the Main Market). The final sample included 177 companies listed on the WSE.

Principle 1.3.1. related to the integration of ESG factors into a business strategy. I wanted to capture the general attitude towards ESG. This part of the research study brought the following conclusions.

Firstly, ESG matters are essential for the companies listed on the WSE. 60% of companies in the examined sample

may be classified as advanced regarding ESG integration into a business strategy (34%) or involvement in meaningful ESG activities (26%). The companies mentioned their activities in reducing emissions of pollutants and greenhouse gases, investing in environmentally friendly technologies or complying with the standards issued by the International Organization for Standardization (ISO) (e.g., Certification ISO 14001 *Environmental Management*). To obtain and maintain this certification, the companies must demonstrate documentation and processes which an accredited auditor audit.

Secondly, twenty-eight companies (16%) may be classified as at a planning stage as they declared future consideration of ESG matters in a formalized business strategy. They demonstrated awareness and a general interest in ESG.

Thirdly, thirty companies (17%) assessed their environmental impact as insignificant due to their office-type business or lack of obligation for non-financial reporting. These are examples of a reduced ESG interpretation that should be avoided. ESG is not only about climate, it is about achieving sustainable growth in financial and non-financial terms. Businesses (including office-based ones) are not exempt from taking care of employees, corporate governance mechanisms, and even small achievable climate-related activities (e.g., energy-saving solutions). The same relates to thirteen companies (7%) that declared other strategic priorities. Apart from the cases of financial difficulties, strategic decisions undoubtedly may be perceived as part of ESG as they create value (especially in the case of innovations) and more jobs.

Principles 1.4. and 1.4.1. related to the disclosure of (1) a business strategy, (2) defined goals, measures, and progress, and (3) ESG, especially climate-related aspects. While companies are eager to engage in ESG activities, revealing strategic data and reporting on ESG is problematic. Only thirty-two companies (18%) declare they entirely comply with both Principles, whereas forty-eight companies (27%) work on a new strategy, including ESG.

The remaining companies present attitudes that may be problematic from the perspective of the ED IFRS S1 and S2. Firstly, twenty-eight companies (16%) treat strategic data as a company secret. Therefore, they may be reluctant to reveal any information, targets, or metrics they consider sensitive (including ESG-related). If such

companies are forced to disclose data, there is a risk that they will present very general and “safe” information.

Secondly, forty-five companies (25%) got used to means already implemented in reporting and communication, including current and periodic reports, internal meetings with the supervisory board, or annual meetings with shareholders. In terms of ESG, it is often associated with non-financial reporting under the NFRD.

Finally, twenty-four companies (14%) may be classified as ESG-neutral. Some companies declare a minor climate impact due to (1) a size or a business type, (2) exemption from the non-financial reporting under the NFRD, or (3) other priorities, such as financial difficulties.

The performed theoretical and empirical parts lead to the following conclusions:

1. ESG undoubtedly became a factor considered by multiple companies. In many cases, it has been proved that we are talking about meaningful and value-driven activities;
2. However, ESG often seems to be additional to the core business. Sixty companies (34%) declare the ESG integration into a business strategy, whereas thirty-two companies (18%) declare they disclose the strategic data, including defined goals, measures, and progress (also ESG-related). It may be concluded that these groups are ready to consider and implement the proposals of the ED IFRS S1 and S2;
3. From the perspective of the ED IFRS S1, ED IFRS S2, and the CSRD proposal, the ESG revolution will be a challenge, especially considering the pace of work progress. Unfortunately, this pace is not in line with the speed of ESG changes happening in many companies currently revising their strategic goals. It does not mean resigning from proposals offered by the standard-setters. However, adaptation to changes requires time and effort;
4. ESG is a concept of sustainable growth which happens while considering Environmental, Social, and Governance factors. Unfortunately, some companies associated the ESG concept mainly with climate-related factors. Such an attitude is risky as it may create a ‘grey area’ of companies feeling exempt from any ESG disclosures because of their size or business type;
5. Moreover, some companies are reluctant to disclose sensitive information and may not be

willing to reveal more than is necessary. It raises a question of how these disclosure requirements will correspond with the reporting quality;

6. Finally, when applied, the ED IFRS S1 and S2 will lead to meaningful changes in financial reporting. Considering the progress of the ESG revolution, it will mean reporting transformation for most companies, i.e., building sustainability-related financial reporting from scratch. An isolated sustainability reporting is currently less and less of a problem, considering companies already reporting carbon footprint or non-financial information under the GRI standards. The biggest challenge is quantifying the impact of sustainability- and climate-related risks and opportunities on financial statements. Such quantification will require advanced risk management tools and the building of an integrated reporting system.

This research study is subject to some limitations. Firstly, it relates to 177 stock-listed companies considered the most sensitive to ESG matters. The sample extension to other sectors may shed light on different aspects or implications. Secondly, the stock-listed companies are classified by regulators as public-interest companies meaning they are under solid regulatory pressure regarding various legal requirements and disclosures. They may exhibit a more disciplined reporting culture than other entities (e.g., private companies); therefore, the attitude towards ESG could be different if we consider entities for whom non-financial reporting is voluntary.

7. Discussions

Implementation of a new standard or a regulation is not easy. Despite the good intentions of standard-setters and regulators, transferring theory to practice can be troublesome, especially regarding international initiatives. It is worth mentioning here that the EU Directives apply to member states with different national jurisdictions and experience in various matters.

Implementing the ED IFRS S1 and S2 is, *per se*, nothing new. In the past, we have already experienced the adoption of International Financial Reporting

Standards. This adoption triggered a discussion in various areas, such as:

- benefits (De George, Li, and Shivakumar, 2016; Horton, Serafeim, and Serafeim, 2013);
- lack of experienced benefits (Jeanjean and Stolowy, 2008);
- market reactions (Armstrong and others, 2010);
- comparison with the US GAAP (Barth and others, 2012);
- audit fees (Kim, Liu, Zheng, 2012).

Regarding the ED IFRS S1 and S2, we should expect *ex-post* contribution in similar areas. The problem is that the standards are not yet implemented (as of August 2022), and the number of *ex-ante* publications is limited. An in-depth analysis of both EDs concerning regulatory requirements in Italy has been proposed by Maria Silvia Avi (Avi, 2022a; Avi, 2022b). In turn, Cavlak (2022) identified a gap between global initiatives (IFRS S1 and S2) and reporting on climate-related aspects in Turkey. The author proposed a conceptual framework to fill this gap.

One empirical study on companies' readiness to adopt the IFRS S2 was prepared by Baboukardos and others (2022). The authors concentrated on the 100 companies with the highest average GHG emissions over 2018-2020 in the construction materials and chemicals industries. They found that companies in both sectors exhibit a moderate overall level of climate-related disclosures prescribed by the ED IFRS S2, which resulted from the majority of sample firms adopting the Recommendations of the Task Force on Climate-Related Financial Disclosures.

Finally, this article leaves room for future research studies. Considering top initiatives such as the European Green Deal, ESG will still be a dynamic factor affecting many companies. Their involvement in ESG matters will change due to rising awareness and external pressure from regulators and standard-setters. Therefore, it is possible to distinguish the following future research areas: (1) ESG-related changes and initiatives happening in the companies, (2) the impact of the CSRD proposal, the ED IFRS S1, and S2, (3) the quality of ESG and non-financial reporting, (4) the role of assurance engagements over ESG information, and (5) the evolution of financial reporting.

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