Questions for the Audit of Green Financial Statements

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SUMMARY

Nowadays, it is also an extremely important issue for businesses to examine and understand the environmental and social effects on the community, since sustainable and competitive operation is becoming a key element. Sustainable development means that we do not fully exploit the resources of any area during development and development for the sake of future generations. This point of view is integrated into politics, the economy, and people's everyday lives. In the case of companies, environmental awareness must not only take effect in production, manufacturing, and final products, but must also be integrated into company systems - including the accounting system - in order to be able to meet the changed expectations. In our study, we examine what processes are currently taking place in the field of environmental awareness, sustainability, and social responsibility, how these elements are integrated into the everyday life of companies, and how information about the interactions between the company and the environment appears in the information published by the companies. Therefore, we review the appearance of environmental accounting issues in the financial reports prepared on the basis of the Accounting Act in Hungary (Act C. of 2000 on Accounting).

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INTRODUCTION, RESEARCH QUESTION

Protection of the environment became an important part of everyday life today (Buallay et al., 2023), reasoned by the increasing emission of waste polluting the environment on the one hand, and the over the long run unsustainable use of natural resources on the other hand. The most important aspect of treating environmental problems is prevention, as a consequence of which the next step of accountancy-evolution took place, mentioned in the technical literature as green (or eco) accountancy (Becsei et al., 2021; Bor & Pál, 2019).

Environmental protection is often associated only with the incurred costs and expenses, they forget about income, profit, and savings, despite the fact that several researches prove that there is a positive relationship between environmental protection and corporate competitiveness, the company's value (Süveges et al., 2022; Selmeczi-Kovács et al., 2020). The result can be positively influenced by the environmental protection subsidies and the improvement of the efficiency of the company's activity, more precisely the reduction of costs (EPA, 2000; Murányi & Borbás, 2016).

Based on the accounting law, the principle of going concern is as follows „Drawing up the financial report and the accounting records shall be based on the assumption of the economic entity's capacity to sustain operations in the foreseeable future and on its ability to continue its activity, and the termination of or a considerable reduction, for any reason, in the operation is not expected". If we interpret this basic principle broadly, we reach the "peak" of green accounting, sustainability accounting, which, using the formulation of Burritt and Schaltegger (2010):

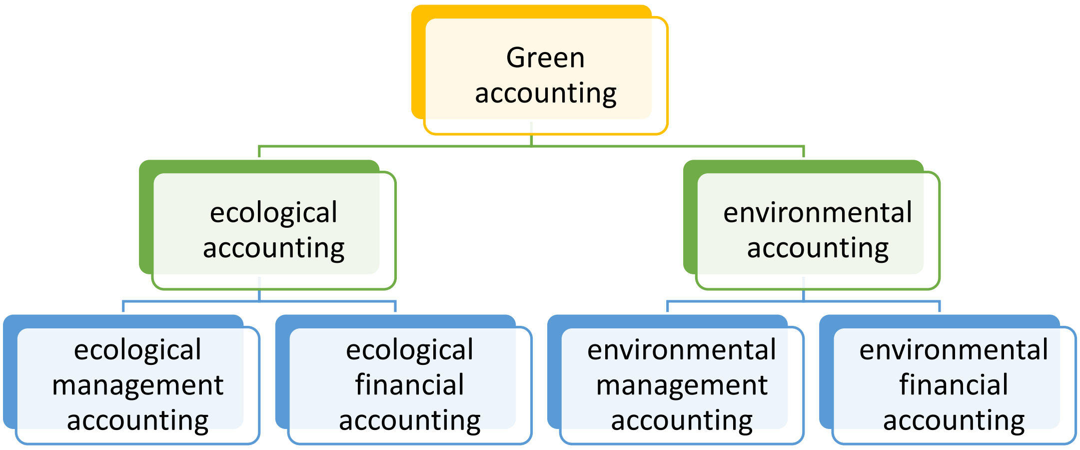
„Sustainability accounting describes a subset of accounting that deals with activities, methods and systems to record, analyse and report:

- First, environmentally and socially induced financial impacts,
- Second, ecological and social impacts of a defined economic system (e.g., the company, production site, nation, etc.), and
- Third, and perhaps most important, the interactions and linkages between social, environmental and economic issues constituting the three dimensions of sustainability." (Burritt & Schaltegger, 2010).

LITERATURE REVIEW

Concepts related to green accounting

Two subsystems of green accounting can be distinguished: on the one hand, ecological accounting that shows the environmental effects of corporate operations, and on the other hand, environmental accounting that reveals their financial consequences. Both subsystems can be divided into two parts: management accounting and financial accounting.



Source: authors' work

Figure 1. Parts of green accounting

Environmental management accounting is a data collection, systematization and analysis activity on environmental emissions and related environmental costs, therefore the information produced can primarily support management in rational decision-making. In contrast, environmental financial accounting presents the company's environmental obligations and costs to stakeholders through financial reports (Henderson, 2023), which influence (can influence) the company's financial situation. Ecological accounting deals with changes in the natural physical environment.

The appearance of green accounting can include:

- Ecological bookkeeping, which is the regular accounting that continuously records the impact of the organization's activities on the environment. Environmental events - which is a concept similar to economic events and includes events that have an impact on the natural environment of the enterprise - are not recorded in money, but in natural units of measurement. (Ecological accounting can be used primarily for analysis, decision-making and control purposes, but the methodology for determining the ecological factors is not yet fully developed and contains many subjective elements.) (Winter, 1997, 35-37).
- Eco-balance, which, by applying systemic thinking, examines the organization's impact on the environment with specific tools. The ecological balance not only takes into account the effects caused in the narrow sense of the factory area, but also the further fate of the manufactured products, i.e. further transport to

other producers, and the amount of environmental damage caused by consumption in households. With its help, it is also possible to manage, control and optimize the environmental effects, however, there is a lack of general and objective evaluation methods, there is a significant range of non-quantifiable environmental effects, the environmental impact of individual materials and procedures is not fully known, and when preparing the balance sheet, it is difficult to demarcate the boundaries of the investigation in space and time (Kerekes & Kindler, 1997, 16-23). Ecological scales are not even scales in the original sense of the word, because they are not bilateral comparisons. It would be more correct to call these analyzes environmental reports, but the jargon has already accepted the use of the term balance sheet (Pál et al., 2003, 213).

- Life cycle analysis, which is actually nothing more than product-level eco-balance. It helps to recognize the actual environmental impacts of a product, but it is a difficulty that the life cycle of any product is connected to the life cycles of countless other products, and where to draw the boundary of the "system" is somewhat arbitrary (Kerekes & Kindler, 1997, 16-23).
- Environmental capital in the balance sheet, which shows the contribution of resources provided by the environment. The value of environmental capital is equal to the external costs caused by the company. The theory is based on the assumption of a hidden social contract, that is, that the environment is also present among the owners of the company. It becomes visible how much of the limited natural resources the company has used. The greater the value of the environmental capital, the further the company moved behind in terms of profitability (Magness, 1997, 15-18).
- Environmental reports, which usually represent environmental goals, policies, and specific problems made public within the framework of annual reports (Kerekes & Kindler, 1997, 42-49). This category also includes the ESG reports explained later.

Appearance of environmental accounting in the report compiled on the basis of the Accounting Act in Hungary (Act C. of 2000 on Accounting).

Among the provisions of the Hungarian accounting act regarding the balance sheet, we can only find a clear provision regarding environmental protection in the sources and provisions. Thus, a provision must be made against the pre-tax profit - to the extent necessary - for those payment environmental protection obligations to third parties arising from past or ongoing transactions and contracts, which are probable or certain to exist on the balance sheet date, but whose amount or due date is still unknown uncertain, and the contractor did not provide the necessary coverage for them in any other way. In addition, a provision can be made for expected costs for such expected, significant and periodically recurring future costs (especially costs related to environmental protection) which on the balance sheet date can be assumed or certain to arise in the future, but their amount or the date of their occurrence is still uncertain and cannot be classified as deferred income.

Despite the fact that it is not named in the law, the following environmental protection-related assets may appear among the assets in the balance sheet:

- the „Capitalized value of research and development”, followed by the capitalized value of environmental improvements,
- in the line of „Concessions, licenses and similar rights”, the right to rent or use environmental protection equipment,
- „Intellectual property products” include environmental protection inventions, patents, technology,
- „Goodwill” can be the value of the acquired company's green image,
- property, equipment, machinery, investments for the purpose of environmental protection in the „Tangible assets” balance sheet group,
- „Stocks” in the balance sheet group are environmentally friendly stocks and waste.

In addition to the nominal provision, the source side of the balance sheet may show:

- „Tied-up reserve”, if the capitalized value of research and development is shown in line with the „Capitalized value of environmental improvements”
- „Liabilities” include environmental protection compensation obligations, loans taken out for environmental protection purposes, and advances received from customers for environmentally friendly products.

In the profit and loss statement, grants awarded for environmental protection purposes may be included as income among other income.

Environmental costs can be:

- cost savings demonstrable in the „Raw materials and consumables”, basic and auxiliary materials not used for production,
- the cost of waste removal, treatment cost, maintenance of environmental protection equipment, cost of education, or licensing fees appearing in the „Value of services consumed”,
- insurance fees related to environmental protection appearing among the „Costs of other services”,
- wages and contributions of those involved in environmental protection appearing among „Staff costs”,

- the depreciation of environmental protection equipment appearing on the „Depreciation" line.

In addition to the balance sheet and profit and loss statement, a number of information related to the environment (protection) must be published in the notes, thus:

- The notes on the accounts shall contain the opening gross value of tangible assets serving environmental protection purposes directly, any increase or decrease therein, any re-classification, the closing gross value, as well as the opening value of accrued depreciation, any increase or decrease therein in the current year, any re-classification, the closing gross value, showing the amount of depreciation in the current year broken down by balance sheet item.
- In the notes on the accounts the quantity and value figures of the opening and closing inventories of any hazardous waste and pollutants, and any increase and decrease in the quantity and value of hazardous waste and pollutants in the current year shall be described by the hazard classifications defined in accordance with the relevant legislation.
- The amount of provisions formed in the current year and in the previous financial year for the purpose of covering environmental protection obligations and future expenses related to environmental commitments, separated by title, the amounts claimed in the current year and in the previous financial year as environmental protection costs, as well as the expected amount of environmental damages and liabilities not included in the balance sheet shall be described in the notes on the accounts (Kántor, 2016).

The business report to be prepared together with the annual report must also cover a number of topics based on the provisions of the Accounting Act, and must be shown in the following way:

- expected development (in line with the development of the business environment, known or anticipated, and with the proposed impact of internal policies);
- any effect of environmental considerations on the company's financial standing, and the company's environment-related commitments and responsibilities;
- environmental protection related projects, completed and anticipated, and any aid in connection therewith;
- the company's policy in terms of the means of environmental protection;
- measures taken for the protection of the environment and their implementation.

The above elements should be supplemented - the 2014/95/EU directive (NFRD, Non-Financial Reporting Directive) and the Accounting Act III. Chapter, 95/C. § - in Hungary, from 2018, certain organizations must also report non-financial data in their business reports.

Large companies which are public-interest entities where:

a) on the balance sheet date in the previous two consecutive financial years either two of the following three indices exceed the limit indicated below:
   - the balance sheet total exceeds 6,000 million forints,
   - the annual net turnover exceeds 12,000 million forints,
   - the average number of employees in the financial year exceeds 250 persons; and
b) the average number of employees in the given financial year exceeds 500 persons;

shall publish a non-financial statement containing information to the extent necessary for an understanding of the company's development, performance, position and impact of its activity, relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters.

The non-financial statement shall at least contain:

- a brief description of the company's business model;
- a description of the policies pursued by the company in relation to environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters, including due diligence processes implemented;
- the outcome of these policies;
- a description of the principal risks related to those matters linked to the company's operations including, in particular, its business relationships, products or services in relation to environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters, which are likely to cause adverse impacts in those areas, and a description as to how the company manages those risks;
- non-financial key performance indicators relevant to the particular business.

However, the law does not specify special sanctions for failure to publish non-financial information, it only mentions the rules of responsibility for violating the accounting rules prescribed by law under the title of legal consequence (Füredi-Fülöp & Várkonyiné, 2022).

Discussion of Main Findings

Trends in non-financial reporting

Nowadays, the idea of sustainability has become an integral part of business life, as responsible investors are no longer only interested in information regarding the assets and liabilities, financial position and profits and losses of businesses, but also on their non-financial characteristics, so in addition to past performance and financial risks, value creation and long-term performance of companies are emphasized.

The sustainability assessment of companies is usually based on three criteria, which are typically referred to by the abbreviation ESG. ESG is the abbreviation of the words Environmental, Social and Governance, which are the pillars of the ESG framework, so these are the three subject areas in which companies are expected to report. The purpose of ESG is to monitor the non-financial risks and opportunities inherent in the everyday activities of companies (Wei et al., 2023).

In September 2015, the 193 member states of the UN committed themselves to balanced social development, sustainable economic growth and environmental protection. The new global development program was unanimously adopted at the summit. The newly adopted program aims to eradicate poverty and build a sustainable future by 2030. The unanimously adopted seventeen Sustainable Development Goals (SDGs) set a new universal standard for development. The objectives and indicators behind the individual development goals are a suitable benchmark for measuring the success of progress (Alapvető Jogok Biztosának Hivatala, 2019).

Source: United Nations. Transforming Our World, 2015.

Figure 2. The UN Sustainable Development Goals

Those financial professionals who follow the ESG strategy already rank companies based on sustainability aspects during their investment decisions. So this is not just a temporary trend, but an attitude increasingly demanded by both financiers and regulators.

Several elements are linked to each ESG pillar, but of course not all of them are equally relevant for different companies. The differences in involvement between individual sectors are called materiality. The factors that can affect the company's financial performance are fundamentally important. The so-called interpretation of the principle of double materiality. This means that not only the factors deemed to be financially relevant must be taken into account during reporting, but also social aspects (Deloitte, 2021).

Companies decide what and how to report based on sustainability reporting standards. Reporting usually takes place along one or more reporting frameworks, which regulate the type and form of disclosures. In line with the needs of investors and other key stakeholders, they demand greater certainty about the authenticity of published data.

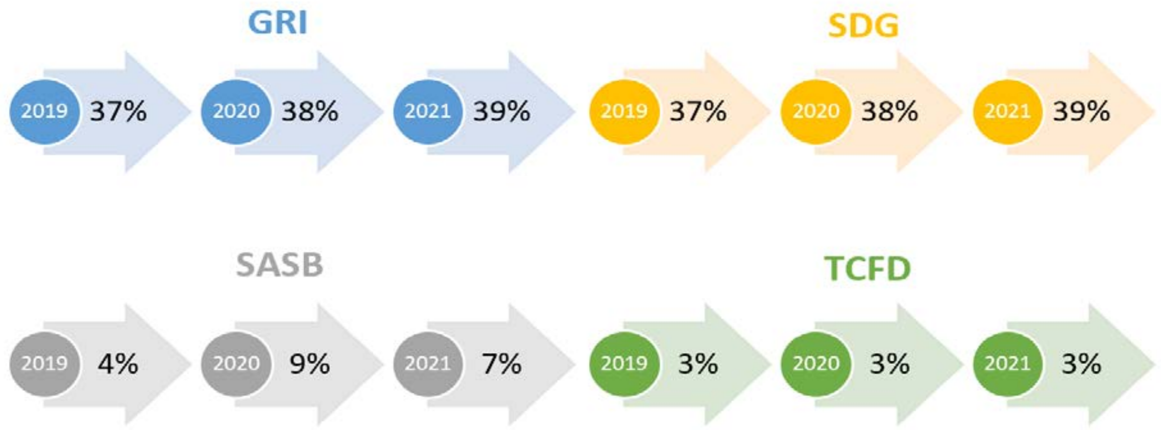
Previous standards issued in relation to non-financial reporting: (Lippai-Makra et al., 2019)

- GRI (Global Reporting Initiative) – which was developed in such a way as to take into account the information needs of all interested groups

and to make their contribution to sustainable development visible in addition to the economic, social and environmental effects of the organization.
- SASB (Sustainability Accounting Standard Board), which is the most widely used industry-specific disclosure standards in the USA.
- IIRC (International Integrated Reporting Council) which aims to create integrated reporting and thinking.
- CDP (Carbon Disclosure Project) which is the world's largest and most comprehensive database on the environmental impacts of businesses and cities.
- TCFD (Task Force on Climate-related Financial Disclosures), or the financial approach to climate risks, which was created in 2015. A voluntary reporting system that aims to inform investors, creditors and insurance companies about their climate-related financial risk in a uniform way.
- CDSB (Climate Disclosure Standards Board) which raises natural capital to the level of importance of financial capital, and created a sustainability reporting framework.

The two most commonly used reporting frameworks are the Global Reporting Initiative (GRI) and the Sustainable Accounting Standards Board (SASB).

Based on the 2023 IFAC, AICPA & CIMA collectively work, it can be seen that the reporting is still not uniform, among the above standards, the number of reports based on the GRI stands out between 2019 and 2021. The distribution ratios shown in Figure 3 show the number of times an ESG framework/standard was referenced in non-financial reports.



Source: IFAC: The State of Play in Sustainability Assurance, 2023

Figure 3. The proportion of references to certain ESG frameworks/standards in non-financial reports

The demand and importance of non-financial reports is increasing nowadays (Mock et al., 2013). Continued regulatory tightening, increasing interest from investors and society present new disclosure challenges to companies. In addition to published sustainability reports, an increasingly common solution is to publish the company's ESG performance on websites instead of or together with the report.

The formal appearance of non-financial reports is regulated by the European Union's efforts, so we can count on significant harmonization regarding the form and content of the previously voluntarily published reports.

A significant step in this is the Non-Financial Reporting Directive (NFRD), which defines general rules for listed companies, banks and insurance companies (Green Finance, 2021). Pursuant to the directive, companies - including banks - had to publish information on environmental, social and employment issues, respect for human rights, bribery and corruption issues to the extent necessary to understand the development, performance, situation and impact of the company's activities.

It is also a significant step that the European Commission published its action plan entitled "Financing sustainable growth" in the spring of 2018, in which three main goals - the redirection of capital flows towards sustainable investments in order to achieve sustainable and inclusive growth; managing financial risks from climate change, resource depletion, environmental degradation and social problems; and the promotion of transparency and a long-term approach in financial and economic activity - the Commission designated ten intervention points.

In November 2019, an EU regulation on sustainability-related disclosures was also published for the financial services industry (2019/2088 EU Regulation - Sustainable Finance Disclosure Regulation, SFDR).

The latest element of the process is the "Corporate Sustainability Reporting Directive" (hereinafter: CSRD) adopted by the Commission on April 21, 2021, which amends the previous reporting requirements of the NFRD (Boros et al., 2022).

The proposal reformed and expanded the range of disclosure obligations, so that from 2023, more than 50,000 European companies will be required to publish a standardized report on compliance with environmental (E), social (S) and governance (G) criteria, which are expected to meet the goals of sustainable development helps to achieve (Hegedűs, 2022).

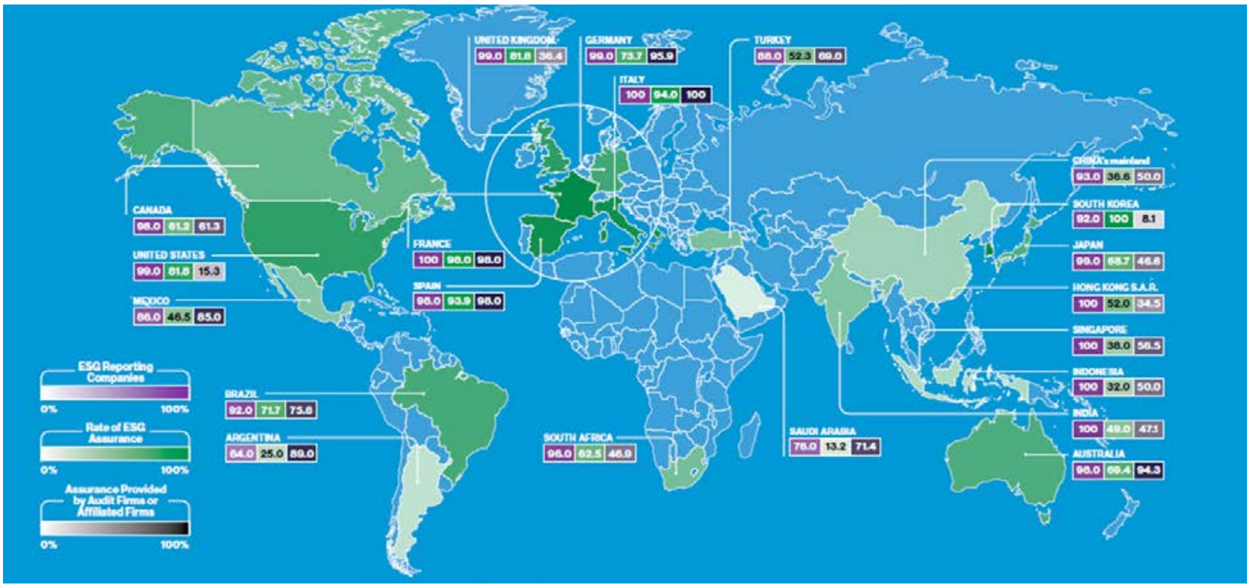
The purpose of CSRD is to ensure that, despite the fact that some of the ESG indicators cannot be directly measured numerically, companies disclose adequate information about the sustainability risks and opportunities they face, as well as their impact on people and the environment (principle of double materiality).

The regulation is applied in three stages:

- On January 1, 2024, for companies already covered by the Non-Financial Disclosure Directive (NFRD), it means large companies listed on EU regulated markets and employing more than 500 employees,
- On January 1, 2025, for large companies that are currently outside the scope of the directive on the publication of non-financial information,
- On January 1, 2026, for listed SMEs and other businesses.

In addition to large companies and companies listed on EU regulated markets, non-EU companies with significant activities in the EU must apply the CSRD regulations from January 1, 2028.

The CSRD therefore introduces a more detailed reporting obligation according to the mandatory EU sustainability reporting standards. In addition, it requires companies to digitally label the reported information so that it is included in the single European access point provided for in the Capital Markets Union Action Plan. However, the CSRD is a directive, so the effectiveness of its implementation will largely depend on its implementation in the Member States. It can be concluded that, as a result of the above processes, we can expect significant changes and definitely progress in terms of the quality, usability and comparability of the information presented (Madarasiné & Győri, 2023).



Source: IFAC: The State of Play in Sustainability Assurance, 2023

Figure 4. Changing global reporting practices in 2021

The demand for the reliability of ESG disclosures is increasing, which means that as the willingness to prepare reports increases, certification also becomes more and more important. This is confirmed by the map in the collectively work of IFAC, AICPA & CIMA, on which we can see the data for the year 2021. The percentage values show the following:

1. what percentage of large companies prepare some kind of report,
2. the proportion of verified ESG reports,

3. in what proportion companies entrusted auditors with the verification of ESG reports and the performance of assurance services, since the external certification can also be performed by an independent consultant or an organization with environmental protection expertise.

The study also examined how, globally The International Auditing and Assurance Standards Board’s (IAASB) International Standard on Assurance Engagements (ISAE) 3000 (Revised) remained the most widely used standard for ESG.

Assurance reports also play an important role in building trust in the reliability of non-financial information. In order to ensure the quality and reliability of the reporting, information related to the sustainability of the company must be provided at a certain level, but it can also be required later to obtain sufficient certainty. In 2023, the IAASB brought forward the public consultation on the new International Standard on Sustainability Assurance (ISSA) Topic 5000, Requirements for Engagements of Sustainability Assurance Services, to August 2-December 1 for agreement, allowing for broad comprehensive agreement and early information acquisition for further development, as well as facilitate the finalization of the standard in 2024.

ISSA 5000 will be a comprehensive standard suitable for both limited and due assurance engagements on sustainability information reported on sustainability topics. The standard will be applicable to sustainability information engagements based on multiple frameworks and will be industry independent, supporting both auditors and assurance providers in the performance of sustainability information assurance engagements.

CONCLUSION

Nowadays, non-financial reports, the publication of ESG information and their applicability in the capital market are highly emphasized areas both in international literature and in corporate practice. Green accounting - as a significant branch of accounting - has long been an integral part of literature studies, however, in the reports published by companies, data on past performance and financial risks are much more prominent than information on environmental impacts.

Today, the idea of sustainability has become an integral part of business life. The so-called responsible investors are no longer only interested in the property, financial and income situation of companies, but also in their non-financial characteristics, so future challenges, value creation and long-term performance of companies become emphasized.

The legal requirements must therefore also be adapted to the needs arising from practical life. Accordingly, the formal appearance of non-financial reports is also regulated by European Union efforts. The latest element of the process is the "Corporate Sustainability Reporting Directive" (hereinafter: CSRD), adopted by the Commission on April 21, 2021, which reformed and expanded the scope of disclosure obligations, so that from 2023, more than 50,000 European the company will be required to publish a standardized report on compliance with environmental (E), social (S) and government (G) criteria, which is expected to help achieve the goals of sustainable development. It can be concluded that, as a result of the above processes, we can expect significant changes and definitely progress in terms of the quality, usability and comparability of the information presented.

The demand for the reliability of ESG disclosures is therefore constantly increasing, as a result of which certification is also becoming increasingly important. Auditors can promote transparent disclosure, thereby contributing to the long-term, sustainable operation of companies.

This growing worldwide demand for clear and transparent disclosure of the long-term ESG obligations of companies and institutions can of course also be felt in Hungary. Domestic investors, suppliers, customers and employees alike want to know and understand the goals and values of the companies they work with. Due to this trend, reporting on non-financial indicators is developing rapidly.

Author’s contribution

Judit Füredi-Fülöp’s contribution to the study is 33%, Gábor Süveges’s contribution to the study is 33%. and Mária Várkonyi Juhász’s contribution to the study is 33%.

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