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THE ROLE OF DISCLOSING SUSTAINABILITY AND CLIMATE RISKS IN ENHANCING THE QUALITY OF FINANCIAL REPORTS FROM THE PERSPECTIVE OF AUDITORS

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ABSTRACT

We aimed to identify the relationship between sustainability risk disclosures, climate change risk disclosure, and financial reporting quality in Iraq for internal and external auditors. The study problem stems from the lack of transparency and inconsistency of information on sustainability and climate change risks and thus the transparency and quality of financial reporting. The study population was internal and external auditors in Iraq. A questionnaire was used as the primary data collection tool and this was sent electronically to a non-probability sample of 210 respondents. It was analyzed using SPSS software. Descriptive statistics showed that sustainability risk disclosure and climate change risk disclosure were rated as average to good in terms of financial reporting quality from the sample's point of view. Pearson's correlation coefficient showed statistically significant positive relationships between the two variables and financial reporting quality (the stronger relationship for climate change risk disclosure). The statistical impact of sustainability risk disclosure, climate change risk disclosure, and financial reporting quality on the analysis of multiple regression methods was also significant (the stronger the correlation coefficient for climate change risk disclosure). The paper concluded that environmental and climate risk disclosure should be strengthened as an effective means of improving financial reporting transparency and quality.

Keywords: sustainability risk disclosure; climate change risks; quality of financial reporting; auditors; iraq

INTRODUCTION

Sustainability and climate change issues have gained more awareness in recent decades due to the increasing economic, environmental, and social impacts of climate change. Those impacts are no longer just environmental threats but big problems that affect organizations' strategic and financial decisions. Climate risks, such as physical risks from extreme weather events or transitional risks due to organizational and technological transition to a low-carbon economy, can have significant impacts on the value of assets, liabilities, and future cash flows of a company, as well as on its ability to continue operating and achieve its long-term objectives (TCFD, 2017; NGFS, 2020) The growing awareness of investors and financial markets of the economic impact of climate risks has shifted the perception of sustainability and climate disclosure from an optional activity within corporate

social responsibility reports to an essential component of corporate reporting. Investors and users of financial reports no longer rely solely on traditional financial information to assess corporate performance; they now require forward-looking information that shows how organizations address environmental, social and governance (ESG) risks and their ability to achieve sustainability in an uncertain business environment (Christensen et al., 2021)

International efforts have helped to develop clear guidance on climate risk disclosure frameworks. The Climate-Linked Financial Disclosures Task Force (TCFD) initiative provided a comprehensive framework based on four pillars: governance, strategy, risk management, and metrics and objectives. The framework is meant to help companies to provide similar information about the impacts of climate change on their operations (TCFD, 2017). The International Sustainability Standards Board (ISSB) was established by the International Financial Reporting Standards Foundation (IFRS) to create a global platform to disclose financial information related to sustainability and climate. This was achieved through IFRS S1 and IFRS S2, which focus on disclosing sustainability and climate risks and opportunities relevant to investment decision-making (ISSB, 2023(Although there have been large-scale developments in the regulation of sustainability and climate risk disclosure, the literature shows significant and wide variation in the quality of disclosure among companies. Many organizations provide general, rather than quantitative information that does not reflect the financial implications of climate risks. Some companies may act as a way to make climate disclosure more transparent and more acceptable to their stakeholders and to raise corporate legitimacy, rather than provide actual, meaningful information that helps stakeholders understand the true risk (Bebbington et al., 2019; Demaria & Rigot, 2021)

Even though global standards and programs related to sustainability and climate risk disclosure have evolved rapidly, there is a gap between rising disclosure requirements and actual practices. Most previous studies have been on advanced economic settings and on the sustainability and climate risk disclosure compliance with international standards and the quality of climate disclosure. However, there is little attention on the role of such disclosure in enhancing the content of financial reports in emerging economies, particularly in

Iraq. Moreover, the evidence has not been provided on how sustainable and climate risk disclosure translates to more relevant financial information for the users of financial reports. This study aims to fill this gap by considering the role of sustainability and climate risk disclosure in financial reports and its role in increasing the quality of financial information and enabling the stakeholders to assess future risks and make sound economic decisions .Based on the above, this study aims to answer the following two questions:

RQ1: To what extent do Iraqi companies adopt the disclosure of sustainability and climate risks?

RQ2: What is the impact of disclosing sustainability and climate risks in financial reports?

LITERATUR REVIEW

This section provides a theoretical framework and relevant prior literature, reviewing theories that explain the relationship between sustainability, climate risk disclosure, and financial reporting, with a detailed assessment of prior research for each variable

Disclosure of sustainability risks and *the quality of* financial reporting

Sustainability risks have become a major issue facing organizations in the business environment today because of the fast pace of changes in environmental, social, and economic factors. The risks to a business's continuity are not limited to just financial risks but also climate change, social responsibility, and governance risks. The recent transition has increased the need for better and more detailed information on these risks in corporate reports so that the information user can assess the organization's true performance and its exposure to future risks (Abraham & Shrives, 2014; Garanina & Dumay, 2017)

The emphasis on sustainability risks is a key factor in the quality of financial reporting due to the role that risk information plays in fostering transparency and reducing investor uncertainty. The quality of financial reporting is not only about the accuracy of accounting data but also about whether the reports provide the right level of data to reflect the company’s real economic situation and the risks that could influence its future performance (Botosan, 1997) therefore, the disclosure of sustainability risks adds a new dimension to financial information, as it

helps to clarify non-financial factors that can have a large impact on the organization's economic value (Dhaliwal et al., 2011)

Stakeholder theory, in effect, states that organizations work on multiple relationships with different parties such as investors, employees, customers and the community. This means that information must be provided not just about financial performance but also about the sustainable future of that organization. So, disclosing sustainability risks is a way to build trust between organizations and their stakeholders and to enhance report quality by making it better at transparency and accountability (Freeman, 1984; Michlon et al., 2015) On the other hand, agency theory explains the relationship between sustainability risks and financial reporting quality as a result of information asymmetry between management and external users. Management has greater knowledge about the future risks facing the organization and if they don't disclose this information, investors might make decisions based on incomplete information. As such, increasing disclosure of sustainability risks can bridge the information gap and enhance oversight of management performance which in turn would enhance the quality of financial reporting (Jensen & Meckling, 1976; Velte, 2017).

There is a lot of evidence that organizations' focus on sustainability issues is associated with better accounting information quality(Dhaliwal et al.,2011).have shown that non-financial information can increase company transparency and influence investor decision making.(Velte ,2017) also found that governance and social responsibility practices are associated with better reporting quality and fewer information problems. (Buallay ,2019) has also found that disclosure of sustainability practices is associated with better performance and corporate transparency, so the positive impact of sustainability information on reporting quality is well established. The recent research indicates that the growing focus on sustainability risks has led companies to reconsider the nature of the information they provide to users. Environmental, social, and governance (ESG) risks are now very much in the picture when we assess organizations' future performance. (Abeysekera et al. ,2021) showed that sustainability disclosure quality is related to financial disclosure quality. In other words, companies that are more concerned with sustainability disclosure have higher

quality financial information. Based on this, we can conclude that sustainability risks are a very important factor in financial reports. Effective management and disclosure of these risks will enable more complete and relevant information to be provided to financial report users and investors to assess the performance of the business and future risks. Therefore, the following main hypothesis can be formulated:

H1: There is a statistically significant effect of sustainability risks on the quality of financial reporting.

Climate risk disclosure and *the quality of* financial reporting

Climate risk disclosure has become a significant topic in the current industry landscape because of the growing impact of climate change on operations, investments, assets, and supply chains. Climate risk disclosure provides clear and transparent data on climate-related risks and opportunities that would assist businesses to better prepare for the future and have a more robust strategic resilience (Leung & Snell, 2019). Climate risk disclosure also drives better risk management, in which organizations are able to anticipate financial, operational, and strategic implications of climate change and take appropriate actions to address them (Andrikopoulos & Kriklani, 2012) Climate risk disclosure is linked to financial reporting quality and transparency, both in terms of information to investors and other reporting users. Climate risk information provides a more complete view of the economic health of the organization and its ability to sustain and generate future value. Good financial reporting should not only provide historical financial data but also relevant and reliable information that informs users to make sound economic decisions (Kanapathippillai et al., 2019)

Climate risk disclosure also reduces the information asymmetry between management and stakeholders and enables the disclosure of potential risks that may have an impact on future financial performance. This is good for financial reporting confidence and confirms its qualitative characteristics of accuracy, reliability, and transparency , As such, organizations that are put in a climate risk disclosure program are better positioned to build investor confidence and competitiveness and drive a transition to more sustainable business practices (Lin et al., 2021).

The literature shows that climate change risk disclosure is not only a form of information but also a strategic tool for

investors to understand the long-term sustainability and resilience of an organization to risk. It also helps risk management and adaptation to climate change (Fritsch et al., 2022). Thus, increased disclosure of these risks will make financial reporting more effective by improving the quality, relevance, and effectiveness of information to support investment decisions.

From the above, it can be argued that disclosing climate change risks is necessary for the quality of financial reporting because it gives information in advance which helps report users to understand the risks and opportunities of sustainability. Therefore, our hypothesis can be established:

H2: There is a statistically significant effect of disclosing climate change risks on the quality of financial reporting.

The complementary impact of sustainability risk disclosure and climate change risk disclosure on the quality of financial reporting

In the present business environment, the quality of financial reporting is increasingly tied to the company's ability to provide comprehensive information about risks that could impact on its performance and sustainability. Traditional financial information is no longer sufficient for the needs of reporting users. Investors and stakeholders now need information related to non-financial risks, especially sustainability and climate change risks, because they could impact the economic value of an organization and its future performance. Hence, integrating sustainability and climate change risk disclosure provides a more complete view of the operating environment and the future risks facing the company, thus enhancing the quality of information in financial reports (Abeysekera et al., 2021)

Climate change risk disclosure is one of the key aspects of sustainability risk and is the financial, operational, and strategic impact of climate change. Sustainability risk disclosure, on the other hand, covers a wider range of environmental, social, and governance (ESG) risks. Companies disclose both types of risks in a systematic way, which allows them to understand the sources of current and future risks, and their impact on cash flows, financial performance, and business continuity as it relates to the quality of financial reporting (Lemma et al., 2020).

The importance of this integration is that it directly affects the qualitative aspects of financial reporting. Disclosure of sustainability and climate risks in

financial reporting is good because it will give investors the opportunity to assess opportunities and risks and to make better decisions. This disclosure also helps in accurate representation, and the company will be able to have a view of the economic situation at the time. It is not just an observation of the past financial year results, but also non-financial aspects that can affect the company's performance in the future (Botosan, 1997; Dhaliwal et al., 2011).

In addition, integrated disclosure of sustainability and climate risks brings about better comparability in companies with regard to the exposure to environmental, social, and climate risks and their management of these risks, which will be better for investors and this will allow investors to make better assessments of different investment options. Because of this risk disclosure, it makes financial reports more comprehensible for users and hence easier to understand the types of risks and the consequences they have as compared to just speculation (Michelon et al., 2015). In addition, integrated disclosure of sustainability and climate risks also reduces information asymmetry between management and investors and therefore makes the risk management process transparent and credible. This is beneficial for users in terms of their trust in financial reports and makes them transparent and reliable. The clearer and more accurate the risk information, the better financial reports can represent the organization's economic reality and support sound decision-making (Ben-Amar et al., 2024).

As applied studies have shown, companies that have advanced practices in disclosing sustainability and climate risks have better transparency and financial reporting quality than others. The reason is not only because of better governance but also better risk management and internal control mechanisms. Recently, climate change risk disclosure has proven to be the key factor to understand the future financial impact of climate risk to investors, as well as the extent to which companies are able to adapt to climate change risks and remain sustainable long term (Ferdous et al., 2025; Abdel Megeid, 2024).

So, integrating sustainability risk disclosure with climate change risk disclosure is not just an extension of published information but also a means to enhance the quality of financial reporting through relevance, honest representation, comparability, understandability and verifiability. Thus, companies that disclose these risks in a systematic

manner will be in a better position to provide more valuable financial information to the reader of financial reports.

METHODOLOGY

Research Design

This study conducted a quantitative research approach to examine the impact of sustainability risk disclosure and climate change risk disclosure on financial reporting quality. A cross-sectional survey design was chosen because this method allows researchers to collect quantitative data from respondents at a single point in time and explore causal relationships among the study variables. The survey method was chosen because a large number of professionals with knowledge of financial reporting and auditing practices could be interviewed.

Population and Sample

These internal and external auditors were selected as a sample of those in Iraq who are experienced in financial reporting and assess the adequacy and credibility of corporate disclosures. The non-probability convenience sampling approach was used to recruit prospective participants using an online questionnaire through Google Forms. The link for the questionnaire was provided through professional and communication channels to internal and external auditors in Iraq. Participation was voluntary and respondents were chosen based on their availability and willingness to participate. This questionnaire was available for a month and 210 valid and complete responses were obtained and stored for analysis purposes. The sample size was considered sufficient for conducting the statistical analyses necessary to test the proposed research model.

Data Collection Procedure

The primary data were gathered through a structured questionnaire constructed using Google Forms. The electronic questionnaire was sent to internal and external auditors through professional networks and communication platforms. The survey was conducted anonymously and the respondents were assured that all information would remain anonymous and confidential and used only for academic research purposes. After one month of data collection, the total number of questionnaires obtained was 210 and they were considered to be suitable for statistical analysis.

Measurement of Variables

The questionnaire consisted of three constructs measured using previously validated scales. Sustainability risk disclosure was measured using six items adapted from (Sulemana et al. 2025). Climate change risk disclosure was measured using six items adapted from , Financial reporting quality was measured using six items adapted from (Mbawuni 2019). To enhance clarity and assure consistency with the Iraqi auditing environment, we made a few minor linguistic modifications without altering the conceptual meaning of the original measurement items. All constructs were measured using a five-point Likert scale from 1 (Strongly Disagree) to 5 (Strongly Agree).

Reliability and Validity Assessment

The reliability of the measurement instrument was tested with Cronbach's Alpha coefficient to assess the internal consistency of the study constructs. As shown in Table (1), all constructs had Cronbach's Alpha values that were above the expected level of 0.70, indicating an acceptance level of internal consistency of the measurement items. In particular, the results show that the items that assess sustainability risk disclosure, climate change risk disclosure and financial reporting quality are reliable enough for the future statistical analyses. Therefore, the measurement instrument is fairly reliable for testing the proposed research model.

Table 1. Reliability and Validity

Categories	Cronbach's Alpha	Validity coefficient
Disclosure of Sustainability Risks	0.781	.884
Disclosure of Climate Change Risks	0.773	.879
Quality of Financial Data	0.793	.890
The Instrument as a Whole (18 items)	0.821	.906

Data Analysis

The data was analyzed with IBM SPSS Statistics. The reliability of the measurement instrument was first measured using Cronbach’s Alpha coefficient, and the measurement scales were checked to make sure that it was up to date on the research instrument. Then descriptive statistical analysis was conducted for the study variables and the characteristics of the respondents were summarized. A Pearson correlation analysis was used to analyze the relationship between the study variables. Finally, multiple linear regression analysis was done to assess the impact of sustainability risk disclosure and climate change risk disclosure on the quality of

financial reporting. We measured statistical significance at the 5% significance level (p 0.

RESULTS AND DISCUSSION

Descriptive Statistics

As we describe the auditors' impressions of the three study variables in a descriptive way, the mean scores are between 3.33 and 3.53, which is in the medium to high range according to the five-point Likert scale (3.41 or higher is considered high, 2.61-3.40 medium). We can also see very low and very close standard deviations (0.58-0.60) of these three variables. This is because the auditors' views about these three variables are very well aligned and not very different. The variable for disclosure of sustainability risks had the highest mean (3.53 and standard deviation of 0.59) indicating a high awareness and confidence among auditors about the role and quality of disclosure of this type in the companies studied. The second variable was the quality of financial data: it was very close (3.49 and standard deviation of 0.60) and the auditors seemed to have a high level of trust in the prepared financial data. The variable for disclosure of climate change risks had the lowest mean (3.33 and standard deviation of 0.58) but was in the middle range. A low score but still an acceptable one can be understood by considering that climate disclosure is a relatively new and specialized aspect and is likely not very practiced in the practical world compared to the broader and well-established concept of sustainability within the field of auditors. In general, the auditors' perceptions of the three study axes were similar, homogeneous and positive (medium to high) which we believe is a reflection of the relatively homogeneous professional awareness of internal and external auditors on the relationship between non-financial disclosures (sustainability and climate change) and the quality of financial data and which theoretically and statistically supports our study's hypotheses about the relationship and influence between these variables.

Table 2. Deceptive Statistics for Study Variables

Categories	mean	Std. Deviation
Disclosure of Sustainability Risks	3.53	0.59
Disclosure of Climate Change Risks	3.33	0.58
Quality of Financial Data	3.49	0.60

Correlation Analysis

Table (3) shows the Pearson correlation coefficient between financial

data quality and the disclosure of sustainability risks and climate change risks. At a significance level of 0.000, the correlation coefficient is less than 0.01, indicating that the relationship between the two variables is not random but rather a real and statistically significant one. The correlation coefficient between financial data quality and sustainability risk disclosure was 0.461, indicating a moderate correlation. In contrast, the correlation coefficient between financial data quality and climate change risk disclosure was 0.612, indicating a relatively stronger relationship. These results can be interpreted as suggesting that increased disclosure of sustainability and climate change risks in companies' financial reports is associated with a relative improvement in the quality of the disclosed financial data. This is because companies that proactively disclose these risks often take more transparent and governance steps, leading to improved financial data quality, reliability, and user-friendliness. However, the low correlation (less than 0.5) indicates that this disclosure is not the sole or decisive factor in determining financial data quality, and that other factors may contribute to this variability.

Table 3. Pearson Correlation Coefficient Between Research Variables

	Quality of Financial Data	(sig)
Disclosure of Sustainability Risks	0.461	0.000
Disclosure of Climate Change Risks	0.612	0.000

Multiple Regression and Hypothesis Testing

Table 4. Hypothesis Testing

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.735	.292		5.944	.000
	x1	.236	.067	.230	3.514	.001
	x2	.276	.068	.266	4.068	.000
	R Square .151	**F:18.502**				

a. Dependent Variable: y

Insight of the first hypothesis (The impact of sustainability risk disclosure x1 on the quality of financial reports y)

From the results in Table (4), the model used to test this hypothesis is statistically sound and acceptable. The coefficient of determination (R-squared) was 0.151 and the calculated F-value was 18.502. Both of which are statistically

significant and confirm the validity and suitability of the model to analyze the relationship between the two variables. In addition, the non-standard regression coefficient (B) was 0.236, the standard regression coefficient (Beta) was 0.230 and the t-value was 3.514 at a significance level of 0.001, which is less than the accepted significance level of 0.05

This supports the hypothesis that sustainability risk disclosure has a significant impact on the quality of financial reports from the perspective of internal and external auditors. The alternative hypothesis is therefore accepted and the null hypothesis is rejected. This is because the disclosure of sustainability risks by companies to auditors and outside users provides them with more information in the field of environmental, social and governance risks that will influence the continuity of the company and its financial position in the future, so that management need to be as accurate and transparent as possible in preparing financial reports to avoid legal accountability and loss of stakeholder confidence and thus the quality of disclosed financial information is appreciated as they are of relevance, reliability and comparability.

The second hypothesis (The influence of climate change risk disclosure x2 on the quality of financial reports y)

Based on the results of Table (4), the non-standard regression coefficient (B) is (0.276), the standard regression coefficient (Beta) is (0.266), and the t-value is (4.068) at significance level (Sig.) of (0.000), which is less than the required significance level (0.05). This confirms the hypothesis that there is a statistically significant impact of climate change risk disclosure on the quality of financial reports from the perspective of internal and external auditors. Hence, the alternative hypothesis is accepted and the null hypothesis is rejected.

It is noted that the impact of this variable (Beta=0.266) was relatively higher than the impact of the sustainability risk variable (Beta=0.230). This is due to the increased global and local interest in climate change issues recently, and the growing regulatory, supervisory and societal pressure on companies to disclose carbon emissions and the physical and transitional climate risks they may be exposed to, which makes auditors more sensitive to this type of risk when assessing the quality of financial reports, because it is directly related to the risks of continuity and the future value of assets and liabilities.

Discussion of Findings

The results of the field study show that the surveyed companies have a moderate to good level of disclosure regarding sustainability and climate change risks in their financial reports from both internal and external auditors. The level of disclosure regarding sustainability risks (mean score 3.53) was somewhat higher than the level of disclosure regarding climate change risks (mean score 3.33). This difference reflects the logical reality that specialized climate disclosure is still in its early stages compared to broader disclosure of sustainability issues, especially given the absence of mandatory standardization such as IFRS S2 in many accounting environments. On the other hand, the overall quality of the financial reports (mean score 3.49) is good, and the auditors believe that the financial output of the companies studied are well-crafted. Looking at the relationship between the study variables, it was found that both sustainability risk disclosure and climate change risk disclosure are positively and statistically significant to the quality of financial reports. The strength of correlation however is different between the two variables, with climate change risk disclosure showing a stronger correlation than sustainability risk disclosure. This variation in the strength of correlation is in line with the results of impact analysis which demonstrated that both variables have a positive and statistically significant influence on financial reports at the level less than 0.05. But climate change risk disclosure had a stronger impact than sustainability risk disclosure, confirming the consistency and statistical validity of the results across different stages of the analysis.

This link between the strength of the relationship and the explanatory effect is attributed to auditors becoming more sensitive to climate risks specifically, as a result of increased global and local attention to these issues recently, and the growing regulatory, supervisory, and societal pressure on companies to disclose carbon emissions and physical and transitional climate risks, given their direct link to the entity's continuity and future financial position. As for the corporate sustainability risks in a broader sense, the impact on financial reporting quality is beneficial because it provides auditors and external parties with additional information about the environmental, social, and governance (ESG) aspects of the company’s risk assessment and therefore helps

management to be more precise and transparent in preparing financial reports so that they can avoid legal liability (in addition to the risk of losing the trust of the public).

It was also found that these two, although complementary dimensions within the setting of modern non-financial disclosure (ESG), explain only a small proportion of the variance in financial reporting quality (no more than 15.1%). While this percentage is statistically significant, it implies that other influential factors are not included in such a model (e.g. corporate governance, entity size, external audit quality, ownership structure). Generally, it can be seen that the relative importance of either variable is not related to the level of disclosure. Although disclosure of sustainability risks was more widespread than disclosure of climate change risks, the latter had a stronger and more significant influence on the quality of financial reporting. This is because the real concern is in the auditors and the users of financial reports and its importance for the assessment of the future risks of the institution and is not so much about the volume or frequency of disclosure itself.

Such results generally support the modern research trend that links non-financial disclosure to the quality of financial outputs and are consistent with Agency Theory and Signaling Theory that voluntary disclosure of non-financial risks reduces the information asymmetry gap between management and external parties and thus improves the quality of accounting information provided.

CONCLUSION

Based on these results, we can conclude therefore the following conclusions can be drawn from this study: (1) The companies surveyed have a moderate to good level of disclosure of sustainability and climate change risks in their financial reports from the auditors' perspective. However, sustainability risk disclosure is more commonly reported than climate change risk disclosure; (2) There is a strong correlation between sustainability risk disclosure and the quality of financial reports. This indicates the importance of this type of disclosure to enhance the transparency and reliability of financial reports and to provide auditors with supplementary information related to the overall risk of the organization; (3) Climate change risk disclosure has a statistically significant and relatively stronger impact on financial report quality compared to sustainability risk disclosure. It is clearly

the growing importance of climate change risk in the present business climate and auditors' sensitivity to it as one of the most serious risks that could potentially jeopardize the organization's continuity in future; (4) A relative importance of either variable is not related to the level of disclosure but to the sensitivity of the auditors and the persons who have written financial reports to the type of information disclosed and its importance to the assessment of future risks. The two independent variables together explain a relatively small fraction of the variance in financial reporting quality. These variables are not a part of the model (corporate governance, company size, external audit quality, ownership structure, etc.) and they can be addressed in future studies; (5) The results of the study support the theoretical explanations of the relationship between non-financial disclosure and financial reporting quality (agency theory and signal theory) and confirm the necessity of companies to disclose more in the future with regard to environmental and climate risks and thus to enhance transparency and reduce information asymmetry between management and the public.

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