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Accounting for sustainability in banking: Role of IFRS and macroeconomic determinants in ESG performance

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Abstract

This research study explores the connection between International Financial Reporting Standards (IFRS) adoption and the Environmental, Social, and Governance (ESG) performance of banks by conducting a panel data study spanning 117 banks and 26 countries from 2009 to 2023. In doing so, the central hypothesis determines whether IFRS adoption, given its principles-based approach and commitment to transparency, offers an implicit improvement in non-financial performance possibilities, specifically in ESG scores. A Prais-Winsten regression model with panel-corrected standard errors is chosen to handle data autocorrelation and heteroscedasticity. The analysis includes accounting standards (IFRS vs. local generally accepted accounting principles (GAAP)), bank size, return on assets (ROA), return on equity (ROE) and macroeconomic variables such as GDP growth, inflation, regulatory quality and unemployment as key independent variables. The findings demonstrate a positive statistical relationship between IFRS adoption and ESG scores which supports the idea that strong financial reporting standards promote better sustainability disclosure. The analysis reveals that bank size demonstrates a powerful positive relationship with ESG performance. The financial performance indicators ROA and ROE fail to show any connection to ESG scores in this particular study. The research reveals that higher regulatory quality produces negative ESG performance while higher unemployment rates lead to decreased ESG scores. The research adds to the expanding dialogue about financial and non-financial reporting standards while demonstrating that IFRS adoption improves transparency in both financial statements and sustainability practices. The research findings provide important practical value for policymakers and investors and corporate decision-makers who need to link financial regulation with sustainable banking practices.

***Keywords*:** IFRS; ESG performance; banking sector; panel data; sustainability; macroeconomic factors; financial reporting

1. Introduction

Corporate performance evaluation now includes a wider perspective which expands beyond traditional profit maximization. ESG performance evaluation has become central to corporate accountability assessments which shows significant changes especially within the financial services industry. Financial intermediaries such as banks must demonstrate financial health and account for their social impact and environmental effects. ESG scores provide extensive evaluation tools to measure banking performance beyond finance by assessing environmental sustainability and ethical conduct as well as corporate governance practices (Friede, Busch, & Bassen, 2015). The financial industry relies on ESG metrics as the main assessment method for corporate sustainability performance while investors and regulators along with other stakeholders require banks to deliver transparent comparable and reliable ESG disclosures (Eccles & Klimenko, 2019). Financial reporting has experienced substantial changes throughout the past few decades. Traditional accounting systems which started as simple financial transaction recorders now operate as complex systems under advanced regulatory frameworks and international standards. The evolution of financial reporting standards occurred because organizations needed better transparency and statement comparability which became essential because of multiple corporate scandals. Financial reporting practices continue to advance through standardization processes which began with basic bookkeeping methods and now include IFRS as evidence of global economic needs. The link between standardized financial reporting frameworks and non-financial performance indicators needs further examination especially in the financial services sector. The IFRS-ESG nexus in banking requires investigation because it establishes a vital link between financial accountability and sustainable business practices. The diverse range of motivations exists to improve transparency and fulfill stakeholder expectations while improving risk management and creating regulatory alignment and building trust in banking institutions. The research investigates if good accounting practices promote good sustainability practices to guide theoretical research on financial reporting behavior and practical guidance for standard-setters and bank executives.

Using panel data analysis alongside appropriate controls this study aims to uncover how ESG practices affect economic conditions and financial outcomes of companies. The proposed study uses a comprehensive analysis framework to study ESG financial performance while incorporating both macroeconomic indicators and individual firm-level ESG attributes. The existing research on ESG performance determinants focuses mainly on company-specific variables including size and profitability as well as ownership structures and national elements such as legal systems and cultural values. Research on how IFRS affects ESG performance lacks thorough exploration particularly when studying banking organizations. The analysis reveals whether financial reporting standards align with sustainability performance goals as complementary elements or work against them as competing factors. This study addresses several significant gaps in the existing literature.

Many studies investigate how IFRS adoption affects financial results like earnings quality (Barth et al., 2008) value relevance (Daske et al., 2008) and capital market effects (Christensen et al., 2013) yet research connecting IFRS to ESG performance remains limited. The banking sector shows an intensified connection between financial reporting and sustainability practices but faces distinctive regulations that create an information gap about this relationship (Scholtens & van't Klooster, 2019). The research objective involves assessing the combined effects of IFRS standards and financial performance indicators and macroeconomic conditions on ESG results in banking through Prais-Winsten regression with panel-corrected standard errors. The research will examine financial reporting standards and their interconnectedness with sustainability performance and macroeconomic factors in banking organizations. The thesis bridges financial and non-financial reporting research dimensions to deliver essential knowledge to academics regulators and sustainability-focused investors through its findings.

2. Literature Review

The IFRS Foundation reports that more than 140 jurisdictions across the world either require or allow IFRS for corporate financial reporting which leads to a global adoption of high-quality accounting standards (IFRS Foundation, 2023). The banking industry has led the way in IFRS adoption since the European Union enforced IFRS for all listed companies including banks during 2005 (Armstrong et al., 2010) and Malaysia South Korea and Turkey adopted IFRS for bank reporting during the 2010s (Pacter, 2014). Major economies such as the United States and China and Japan maintain local GAAP standards (Zeff, 2012). The existence of multiple financial reporting systems across the world establishes a research opportunity that resembles a natural experiment. The analysis of ESG performance relationships with different financial reporting regimes becomes essential for research purposes. The principles-based nature of IFRS combined with its emphasis on transparency and full disclosure and comparability (Barth et al., 2008) suggests that banks using IFRS would demonstrate enhanced ESG disclosure and management because of better reporting quality and stakeholder communication (Christensen et al., 2021). The direct influence of accounting standards on bank ESG commitment remains unclear because cultural factors and market conditions and regulatory elements might play a more significant role (Ioannou & Serafeim, 2012). The research aims to resolve a literature gap by investigating the relationship between accounting standards and bank ESG performance despite the absence of explicit accounting standard analysis in previous studies.

The investigation of IFRS's effects on ESG holds practical value because financial reporting quality and sustainability reporting show potential synergies. Financial statements under IFRS adoption become more transparent and comprehensive according to Barth et al. (2008). The enhanced transparency from IFRS adoption creates a positive effect on non-financial disclosures because firms develop better reporting systems and establish open accountable practices (Christensen, Hail, & Leuz, 2021). Recent evidence supports this view. Kwakye et al. (2022)

studied 28 firms from 2003 to 2013 to discover that IFRS adoption resulted in better CSR (corporate social responsibility) disclosure quantity and quality in annual reports. The implementation of IFRS led firms to disclose ESG-related information more openly. The effect became more significant among firms that operated internationally because they needed to address stakeholder expectations from multiple regions. The study's findings about IFRS implementation benefits ESG reporting and performance monitoring through better disclosure quality and internal control systems and data credibility that apply directly to the banking sector.

The theoretical links between financial reporting standards and sustainability performance have not been supported by sufficient empirical research which studies IFRS adoption effects on ESG scores especially in banking institutions. The current research shows multiple important gaps which this study seeks to resolve. Most research on IFRS adoption consequences has concentrated on traditional financial metrics and market outcomes. The literature shows that IFRS affects earnings quality (Barth et al., 2008), value relevance (Devalle et al., 2010), cost of capital (Li, 2010), analyst forecast accuracy (Horton et al., 2013), and foreign direct investment (Gordon et al., 2012). The impact on non-financial dimensions of corporate performance, especially ESG metrics, has been relatively neglected, thus creating a significant knowledge gap. The current research on IFRS and sustainability focuses mainly on disclosure practices instead of actual sustainability performance. The studies by Tschopp and Nastanski (2014) and Moneva and Cuellar (2009) analyze how IFRS adoption influences sustainability reporting practices but they do not evaluate whether these modified practices lead to better environmental stewardship and social responsibility and governance quality outcomes. The research gap exists between disclosure practices and actual performance measurement.

Most sustainability accounting research has focused on manufacturing, extractive or consumer-facing industries that have an obvious environmental impact (Dienes et al., 2016). The banking sector, despite its profound indirect sustainability impacts through financing activities, remains underrepresented in the literature. Financial institutions operate within distinctive regulatory environments and face unique sustainability challenges that may alter the relationship between reporting standards and ESG performance. The banking sector has unique characteristics (systemic importance, heavy regulation, high information asymmetry) that make the IFRS-ESG linkage particularly worth studying. Banks' adoption of IFRS was often part of broader financial sector reforms to improve transparency and stability (as seen after financial crises). At the same time, banks are instrumental in driving sustainability in the economy by allocating capital, e.g. through green loans or screening clients on ESG criteria. Several specific IFRS provisions have direct relevance for sustainability accounting in banking contexts. IAS 37 (Provisions, Contingent Liabilities and Contingent Assets) influences how banks account for environmental liabilities, remediation obligations, and legal contingencies arising from sustainability-related activities or violations. IAS 36 (Impairment of Assets) affects the valuation of assets whose values may be

compromised by sustainability factors, including potential write-downs of carbon-intensive assets facing transition risks (Deegan, 2013). IFRS 7 (Financial Instruments: Disclosures) requires risk disclosures that increasingly encompass climate-related and other sustainability risks affecting financial instruments (TCFD, 2017). IFRS 9 (Financial Instruments) influences how expected credit losses incorporate forward-looking information, potentially including climate scenarios and other sustainability considerations (Deloitte, 2020). IFRS adoption has generally improved financial risk reporting through standardized disclosures, particularly with IFRS 7's comprehensive requirements for financial instrument risk disclosures (Bischof & Daske, 2013). The implementation of IFRS 9 has further enhanced credit risk reporting by introducing the expected credit loss model, which requires forward-looking assessments (Novotny-Farkas, 2016). ESG factors increasingly represent material risks for banks. Environmental risks include direct exposure to climate-related physical and transition risks in loan portfolios (Bolton et al., 2020). Social risks encompass reputational damage from financing controversial industries or projects with adverse human rights impacts (Weber et al., 2014). Governance risks involve internal control weaknesses that could lead to compliance failures or misconduct (Mehran et al., 2012). If IFRS adoption improves banks' risk reporting, one could hypothesize it might also encourage banks to better manage long-term risks including environmental or social risks, thereby indirectly boosting their ESG performance.

The fourth limitation of existing research is that it views IFRS adoption as a standalone event without examining its relationship with organizational characteristics and macroeconomic factors. The relationship between reporting standards and sustainability performance is likely moderated by institutional ownership, board composition, market competition, and regulatory environment (Ioannou & Serafeim, 2012). This study addresses this gap by incorporating these contextual elements into its analytical framework. The integration of ESG considerations by banks with financial reporting practices such as IFRS requires a solid theoretical foundation for understanding this practice. Two main theories explain the connection between accounting standards and ESG disclosure: stakeholder theory and legitimacy theory. According to stakeholder theory firms must fulfill their obligations to all stakeholders including shareholders and regulators and customers and employees and the broader community. The combination of high-quality ESG disclosure with transparent financial reporting under IFRS serves to meet various stakeholder demands according to Freeman (1984) and Donaldson & Preston (1995). According to legitimacy theory firms use ESG reporting to validate their actions while matching societal expectations (Suchman, 1995). IFRS promotes transparency and comparability which enhances corporate legitimacy in global investor markets thus motivating firms to disclose ESG information (Deegan, 2002).

Numerous previous studies have investigated the relationship between ESG performance of banks and their financial outcomes. The research question investigates whether banks with superior ESG scores tend to achieve superior financial results through better returns on equity/assets and market

valuation. The research evidence shows a positive relationship, but different studies and settings produce varying outcomes (Friede, Busch, & Bassen, 2015; Velte, 2017). The previous research shows important findings, but most studies failed to analyze differences between IFRS and local GAAP accounting standards which the current review seeks to address.

Multiple meta-analyses across different industries demonstrate that organizations with strong ESG performance achieve financial results that are equal to or superior to their peers. The analysis of more than 1,000 studies spanning from 2015 to 2020 demonstrated that 58% of corporate studies which evaluated ROE, ROA and stock price performance discovered positive ESG-financial performance links but negative findings occurred in only 8% of cases (Whelan, Atz, & Van Holt, 2021). The positive relationship between ESG and financial performance exists in banking-specific studies which include banks as part of their samples. The combination of effective management and reduced risk which ESG ratings indicate leads to superior profitability and market value according to stakeholder theory (Freeman, Harrison, & Wicks, 2007). The business case for ESG in banking receives support from empirical research conducted across different geographic areas. Research conducted by academics demonstrates that banks with superior ESG scores achieve superior ROA and ROE performance and receive better market valuation multiples than banks with lower ESG scores (Nollet, Filis, & Mitrokostas, 2016; Velte, 2017).

In a study of Asia-Pacific banks, Ahmed et al. (2023) found that composite ESG disclosure scores had a significant positive impact on both ROA and ROE, and similarly positive effects were observed for European banks in other research (Pyo & Lee, 2013; Buallay, 2019). These findings align with the idea that ESG efforts, such as improving customer trust through social responsibility or reducing long-term environmental risks can enhance a bank's efficiency, reputation, and ultimately financial returns. Not all studies find uniformly positive results; some report neutral or mixed effects, and a few find negative short-term impacts of certain ESG activities on profitability. For instance, investments in environmental initiatives could impose costs that, in the short run, weigh on ROA or ROE (Drempetic, Klein, & Zwergel, 2020). In the Asia-Pacific study mentioned, one reference cited in their review found that while overall ESG disclosure was positively linked with bank performance, the environmental component of ESG had a negative effect on ROA in some cases. Similarly, research on Chinese and Malaysian firms found that higher environmental disclosures were associated with slightly lower current profits, possibly due to the costs of pollution control or compliance (Zhang et al., 2020; Arshad et al., 2012). However, even in such cases, the market often views the environmental efforts favorably, those studies noted a positive relationship with market valuation despite the ROA decrease. This suggests a potential trade-off between short-term accounting returns and long-term value: heavy investment in ESG (especially environmental projects) might reduce immediate profits but increase future competitiveness and reduce risk, which investors reward (Eccles, Ioannou, & Serafeim, 2014). Another study by Buali et al. (2021), focusing on Middle Eastern banks, found that overall ESG scores had a negative

effect on short-term market performance in that region, possibly reflecting investor skepticism or implementation costs, though this appears to be an outlier result. By and large, the "profitability versus sustainability" trade-off appears to be becoming less severe as stakeholder expectations evolve: many banks manage to do both well.

The adoption of IFRS standards leads to better financial reporting quality and reduced information asymmetry and improved cross-jurisdictional comparability (Barth, Landsman, & Lang, 2008). The essential features of ESG reporting need these attributes because the field lacks standardization and depends on managerial discretion. IFRS disclosure standards create better ESG transparency and consistency according to several scholars because they apply to firms that operate in international capital markets (Ioannou & Serafeim, 2012). The IFRS framework offers precise instructions about asset recognition and liability measurement which helps decrease earnings management and makes ESG disclosures more representative of actual firm performance (Christensen, Lee, & Walker, 2015). The literature review unites theoretical frameworks with research evidence to present IFRS adoption perspectives. The stakeholder, and legitimacy theories indicate that banks have incentives to pursue both high-quality financial reporting and strong ESG performance in order to satisfy stakeholders, maintain societal approval, and comply with evolving norms. The empirical research demonstrates a generally positive connection between ESG scores of banks and their financial results but this relationship depends on specific circumstances.

3. Methodology

The research study uses quantitative methods through panel data analysis to analyze how accounting standards affect ESG performance in banks. The research sample consists of 117 banks located in 26 countries which provides extensive geographic coverage and diverse economic conditions. The research includes an equal number of banks operating under IFRS-adopting countries and local GAAP countries for comparative evaluation purposes. The sample includes 21 countries which either require or allow IFRS financial reporting standards, and these countries contribute 58 banks to the study while 5 countries with local GAAP systems contribute 59 banks. The IFRS-adopting group contains European countries (United Kingdom, Germany, France, Italy, Spain and others) together with Asian and emerging economies that have adopted IFRS (Malaysia, South Korea, Turkey). The local GAAP group consists of major economies that did not adopt IFRS for domestic banks during the sample period including the United States (US GAAP), China (Chinese Accounting Standards (CAS)), Japan (J-GAAP), India (Indian Accounting Standards (Ind AS)) and Indonesia (Indonesian Financial Accounting Standards (SAK)). The five countries either maintained their national GAAP or enabled IFRS to be used on a voluntary basis but did not enforce full adoption. Table 1 presents the definitions and operationalization of the variables.

Table 1. Definitions and Operationalization of the Variables

	Variable	Full variable name	Source	Definition
1	ESG score (dependent)	Environmental, Social, and Governance score	Refinitiv Eikon database (LSEG)	Measures a bank's combined environmental, social, and governance performance, range from 0 to 100
2	Dummy (independent)	Accounting Standards (IFRS vs. GAAP)	Refinitiv Eikon database (LSEG)	This binary variable distinguishes between banks that follow IFRS (coded as 1) and those that follow local GAAP (coded as 0).
3	Size (independent)	Total Assets	Refinitiv Eikon database (LSEG)	Measured as the natural logarithm of total assets of the bank
4	RoA (independent)	Return on Assets	Refinitiv Eikon database (LSEG)	Profitability measure is calculated as net income divided by total assets
5	RoE (independent)	Return on Equity	Refinitiv Eikon database (LSEG)	Net income divided by shareholders' equity, ROE measures a bank's profitability in relation to its equity.
6	GDP growth (independent)	GDP growth	World Bank database	Growth rate of GDP per year
7	Inflation (independent)	Inflation rate	World Bank database	Annual change in consumer price index for each country
8	RegQual (independent)	Regulatory quality	World Bank database	Perceptions of the government's ability to formulate and implement sound policies and regulations that permit and promote private sector development.
9	UnEmploy (independent)	Unemployment rate	World Bank database	Annual unemployment rate for each country

The following diagnostic tests were performed to validate the regression analysis results:

- Stationarity test: The test was conducted to verify if time series variables show stationary characteristics. The results showed that the dataset did not present any stationarity problems.
- Multicollinearity test: The Variance Inflation Factor (VIF) analysis was used to identify potential multicollinearity between independent variables. The independent variables showed no significant multicollinearity because they did not demonstrate strong correlations with each other.
- Autocorrelation test: The Wooldridge test for autocorrelation in panel data showed that the dataset contained significant serial correlation. The presence of serial correlation required the application of specialized regression techniques to resolve this issue.
- Heteroscedasticity test: The Breusch-Pagan test results showed that heteroscedasticity existed in the dataset. The results confirmed the requirement for robust estimation methods.

4. Findings and Discussion

The diagnostic test results showed autocorrelation and heteroscedasticity, so a Prais-Winsten regression with panel-corrected standard errors was used. This method is particularly suitable for panel data with autocorrelation and heteroscedasticity problems as it gives more accurate standard errors than ordinary least squares (OLS) regression (Beck & Katz, 1995).

The regression model is specified as follows:

$$ESG\ score = \beta_0 + \beta_1\ Dummy + \beta_2\ ln(Size) + \beta_3\ ROA + \beta_4\ ROE + \beta_5\ GDPgrowth + \beta_6\ Inflation + \beta_7\ RegQual\_it + \beta_8\ Unemployment + \varepsilon$$

Table 2 below presents the regression results, with ESG score as the dependent variable and various bank-specific and macroeconomic factors as independent variables.

Table 2. Results of Regression Analysis

	Variable	Coefficient	p-value	Interpretation
1	Dummy	6.96	**0.000**	Strong significant positive effect
2	Size	21.89	**0.000**	Strong significant positive effect
3	RoA	0.19	0.997	Not significant
4	RoE	0.16	0.839	Not significant
5	GDP growth	0.06	0.495	Not significant

6	Inflation	0.13	0.119	Not significant
7	Regulatory Quality	-10.6	**0.000**	Strong significant but surprisingly negative
8	Unemployment	-0.43	**0.043**	Significant and negative

The significant positive relationship between IFRS adoption and ESG scores serves as the primary outcome of this research. The correlation shows banks' accounting framework through IFRS or local GAAP affects their ESG performance strongly because IFRS adopters achieve substantially higher ESG scores than banks using local GAAP. IFRS adoption produces these results because this principles-based accounting framework demands transparency and complete disclosure and stakeholder communication. The research of Barth et al. (2008) demonstrates how IFRS adoption enhances transparency and international comparability in financial reporting which leads to positive side effects in ESG disclosure practices. IFRS adoption produces better corporate information environments that go beyond traditional financial reporting according to Daske et al. (2013).

The positive relationship between bank size and ESG scores supports the theory that bigger banks encounter more regulatory and investor monitoring which strengthens their need to prove ESG commitment (Scholtens, 2009). Larger institutions have an advantage when it comes to ESG investments because their fixed costs become more manageable due to their extensive asset base (Deng et al., 2013). The regression did not identify any statistical relationships between ESG scores and financial performance indicators (ROA and ROE) which stands in contrast to other studies that found connections between financial and ESG performance. Our results can be explained through multiple reasons. The connection between ESG performance and financial results demonstrates complex patterns which exceed straightforward linear linkages. Barnett and Salomon (2012) suggest that financial outcomes can improve at both ends of the ESG performance spectrum through distinct methods. The linear nature of our model fails to detect potential non-linear relationships between these variables.

The strongest unexpected result emerged as a negative relationship between regulatory quality and ESG scores. This result goes against theoretical predictions that better regulatory quality would lead to improved ESG performance because it enables stronger enforcement of environmental and social regulations and more transparent requirements and stringent governance standards (La Porta et al., 2008; Ioannou & Serafeim, 2012). The negative relationship between unemployment rates and ESG scores matches theoretical models about how economic conditions affect corporate sustainability initiatives. The results indicate that banks operating under higher unemployment conditions will have lower ESG scores even when other variables remain constant.

5. Conclusion, Recommendations, and Future Research Directions

The research investigated IFRS adoption effects on ESG performance throughout global banking institutions across 15 years from 2009 to 2023. The research used Prais-Winsten regression modeling with panel-corrected standard errors to conduct robust empirical analysis of panel data while addressing autocorrelation and heteroscedasticity issues. The study found a statistically significant positive relationship between IFRS adoption and ESG scores thus supporting the notion that standardized financial reporting leads to better sustainability outcomes for banks.

The findings of this research hold essential implications for both theoretical frameworks and practical applications. The results demonstrate that stakeholder theory and legitimacy theory both provide valuable explanations of banking institutions' ESG performance. When banks implement IFRS they demonstrate their dedication to transparency as well as accountability in both financial reporting and social and environmental aspects. The full disclosure and comparability standards of IFRS create an indirect effect on ESG performance by encouraging better sustainability reporting. The research holds specific significance for regulators alongside investors and bank executives. Investors could use IFRS adoption as a signal to identify potential ESG reliability while regulators should explore financial reporting reforms that align with sustainability mandates. The strategic value of standardized reporting practices becomes evident for banking institutions because they enable them to fulfill stakeholder demands and manage future risks. Larger banks tend to have better ESG performance according to the study because they possess more resources and attract more stakeholders while facing increased scrutiny which leads to improved ESG engagement. Financial indicators like ROA and ROE failed to establish any significant relationship with ESG performance. ESG considerations operate on different temporal or strategic horizons because profitability remains fundamental for financial performance. The study revealed an unexpected negative link between regulatory quality and ESG performance which demands additional investigation about regional or institutional factors that influence this relationship. Higher unemployment rates showed a negative correlation with ESG scores indicating how economic conditions impact corporate sustainability actions.

The research establishes essential connections between financial reporting systems and sustainability scholarship. IFRS demonstrates its potential to impact both financial transparency and ethical environmental and governance standards. The research findings demonstrate how accounting standards create long-term value alongside corporate accountability through their influence on business conduct. Future research should investigate causal relationships more deeply while including industry-specific sustainability measures and extending ESG integration analysis to qualitative aspects. The research positions IFRS within sustainable finance discourse to demonstrate how accounting regulation can transform the banking sector toward greater responsibility.

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