

IFRS S2 Climate Disclosure and Its Impact on SME Financing Decision: An Overview

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Received: 25 October 2025 | Accepted: 1 December 2025 | Published: 31 December 2025

DOI: <https://doi.org/10.55057/ijaref.2025.7.4.11>

Abstract: *The global emphasis on sustainability has elevated the importance of standardized climate-related disclosures, such as IFRS S2, for corporate reporting and financing decisions. Small and medium-sized enterprises (SMEs), however, face significant challenges in adopting these standards due to low awareness, limited technical expertise, and constrained resources. This study provides an overview of the current evidence on SME engagement with IFRS S2, focusing on awareness, incentives to disclose, and the financial implications of non-disclosure. A systematic review of literature, reports, and official publications from 2020 to 2025 was conducted, covering sources from the IFRS Foundation, OECD, ACCA, ISSB, and peer-reviewed journals. Findings indicate that SMEs often struggle to interpret technical reporting requirements and operationalize climate disclosure practices. Furthermore, the absence of explicit financial, regulatory, or reputational incentives reduces voluntary participation, while non-disclosure exposes SMEs to potential financing barriers, including restricted access to loans, smaller loan sizes, higher interest rates, and stricter collateral requirements. These results highlight a divide between disclosure-ready SMEs and non-disclosure SMEs, emphasizing both operational and financial vulnerabilities within the sector. The study underscores the need for tailored guidance, capacity-building initiatives, and incentive mechanisms to enhance SME readiness and promote broader adoption of IFRS S2. By synthesizing current evidence, the research provides actionable insights for policymakers, standard-setters, and financial institutions to facilitate SME engagement with climate reporting, mitigate perceived credit risks, and support equitable access to sustainable finance.*

Keywords: IFRS S2, climate disclosure, SMEs, financing barriers, sustainability reporting

1. Introduction

The increasing global emphasis on sustainability has elevated the importance of standardized climate-related disclosures, such as those outlined in IFRS S2, for corporate reporting and financial decision-making. Despite this, evidence suggests that small and medium-sized enterprises (SMEs) face significant challenges in adopting these standards due to low awareness, limited technical understanding, and constrained resources (IFRS Foundation, 2025; OECD, 2025; Verawaty, Gunawan, & Nuryatno, 2025; Setiawan et al., 2025). The complexity of IFRS S2 terminology, metrics, and governance requirements often exceeds the internal capacities of smaller firms, creating a persistent knowledge and implementation gap. Compounding this issue is the lack of explicit financial or regulatory incentives: SMEs frequently perceive climate disclosure as costly and burdensome, with unclear benefits such as

enhanced access to finance or market credibility (Agustini & Arifa, 2024; Wahyuni, 2025; de Bortoli et al., 2025).

This gap has practical implications for SME financing. Firms that fail to disclose climate-related or ESG information are increasingly perceived as higher-risk borrowers, resulting in restricted access to credit, smaller loan sizes, higher interest rates, and stricter collateral requirements (Jafar, Basuki, Windijarto, & Setiawan, 2024; Mustafa, Chen, Atqa, & Lin, 2025; MDPI Systems, 2025). Consequently, a divide emerges between disclosure-ready SMEs and non-disclosure SMEs, reflecting both operational and financial inefficiencies within the SME sector. The central problem addressed in this study is threefold: (1) SMEs' limited awareness and understanding of IFRS S2, (2) insufficient incentives to engage in climate disclosure, and (3) the financing barriers faced by non-disclosure SMEs. Addressing these issues is critical to enhancing the effectiveness of IFRS S2 adoption and supporting SMEs' access to sustainable finance.

Accordingly, this research aims to examine how awareness, incentives, and disclosure practices under IFRS S2 influence SME access to finance. To achieve this aim, the study investigates three intermediate objectives: (1) assessing SME awareness and capacity to implement IFRS S2, (2) evaluating the perceived costs, benefits, and incentives for climate disclosure, and (3) analyzing the relationship between disclosure practices and financing outcomes such as credit approval, loan size, and interest rates. By exploring these interrelated challenges, the study contributes to understanding the factors that facilitate or hinder SME engagement with climate reporting and offers insights for policymakers, standard setters, and financial institutions seeking to promote sustainable finance in the SME sector.

2. Literature Review

2.1 Low SME Awareness and Understanding of IFRS S2

Global evidence suggests that awareness and capacity to implement IFRS S2 remain constrained, especially among smaller and less-resourced entities. The IFRS Foundation's (2025) Jurisdictional Roadmap Development Tool acknowledges that many entities "lack resources due to their size ... absence of high-quality external data, or difficulty in obtaining the necessary expertise." Although 36 jurisdictions are pursuing adoption of ISSB standards, the IFRS Foundation's (2025) jurisdictional profiles reveal that many are still in the early stages of implementation, with support for smaller entities identified as a key capacity-building need. Moreover, the IFRS Foundation's 2024 progress report on corporate climate-related disclosures indicates that, while many companies have begun referencing ISSB standards, the application of detailed IFRS S2 requirements such as Scope 3 emissions remains limited across the board (Latham & Watkins, 2024).

Despite the increasing global emphasis on sustainability reporting, SMEs exhibit low awareness and limited understanding of IFRS S2 climate-related disclosure requirements, largely due to the technical complexity of the standards and constrained resources. OECD (2025) highlights that many SMEs are not yet ready to adopt IFRS S1 and S2, citing limitations in internal expertise, data collection, and reporting infrastructure, and recommends simplified pathways to facilitate gradual alignment. Similarly, Verawaty, Gunawan, and Nuryatno (2025) find that early-stage readiness is prevalent among smaller companies in Indonesia, reflecting widespread difficulties in interpreting and applying the technical metrics and governance requirements of IFRS S2. Supporting this, Setiawan et al. (2025) demonstrate that smaller firms often struggle to localize and operationalize IFRS S1 and S2 within their sustainability

practices, underscoring a persistent capacity gap that could hinder SMEs from effectively engaging with banks and other stakeholders on climate-related disclosures. Collectively, these studies indicate that tailored guidance, capacity-building initiatives, and simplified disclosure frameworks are essential to enhance SME readiness for IFRS S2 implementation.

2.2 Lack of Incentives for SMEs to Disclose

Despite the global adoption of IFRS S2, smaller firms and SMEs often lack sufficient incentives to engage in climate-related disclosures, largely due to the high cost, complexity, and limited perceived benefits of reporting. The ISSB (2025) has acknowledged these challenges by proposing targeted amendments to IFRS S2 aimed at reducing reporting burden, particularly in areas such as Scope 3 emissions, yet these measures primarily relieve obligation rather than provide positive incentives for SMEs to disclose (ISSB, 2025). KPMG (2025) similarly notes that while clarifications balance investor needs with preparer burden, smaller entities remain constrained by resource limitations, suggesting that compliance may be seen as onerous rather than advantageous. Supporting this, ACCA (2025) reports that many companies, especially SMEs, currently provide minimal or no disclosure on the new IFRS S2 requirements, highlighting that without targeted support or incentives, these firms are unlikely to voluntarily engage in comprehensive climate reporting. Collectively, these findings indicate that the absence of explicit financial or regulatory incentives continues to hinder SME participation in IFRS S2 climate disclosure.

Although IFRS S2 aims to standardize climate-related disclosures globally, SMEs often lack sufficient incentives to engage in such reporting, largely due to the perceived costs, complexity, and unclear benefits. Agustini and Arifa (2024) note that, despite the potential for improved legitimacy and stakeholder trust, many smaller firms do not adopt climate reporting because standardization and clarity of benefits remain limited. Wahyuni (2025) further highlights that IFRS S2 adoption is uneven among SMEs, as these entities often struggle to perceive tangible advantages from disclosure, such as access to cheaper financing or faster approval processes. Additionally, de Bortoli et al. (2025) emphasize that without clear accounting guidance and supportive frameworks, organizations including smaller firms may face significant reporting burdens that outweigh perceived incentives. Collectively, these studies suggest that the absence of explicit financial, regulatory, or operational incentives continues to constrain SMEs' engagement with climate disclosure under IFRS S2, underscoring the need for targeted support mechanisms to enhance participation.

2.3 Potential Financing Barriers for SMEs Without Climate Disclosure

SMEs that do not provide climate-related or sustainability disclosures face increasing challenges in accessing finance, particularly as financial institutions and investors prioritize environmental performance. The OECD (2024) reports that banks and other lenders are progressively incorporating sustainability data into credit assessment processes, and SMEs lacking climate information may be perceived as higher risk, limiting access to green or transition financing. Similarly, SEED (2024) highlights that insufficient sustainability reporting, combined with high transaction costs and limited advisory support, creates barriers that prevent many climate-smart SMEs from securing financing. The International Chamber of Commerce (ICC, 2024) further emphasizes that financial institutions struggle to underwrite green or sustainability-linked loans for SMEs that do not provide verifiable climate or environmental data, illustrating the practical financing disadvantages for smaller firms without proper disclosures. Collectively, these findings suggest that absence of climate disclosure constitutes a significant barrier to SME financing in the emerging sustainability-driven financial landscape.

SMEs that fail to disclose climate-related or ESG information may face significant financing barriers, as lenders increasingly incorporate sustainability performance into credit assessments. Empirical evidence suggests that firms with comprehensive ESG disclosures benefit from lower borrowing costs and more favourable lending terms, whereas non-disclosure is associated with higher perceived credit risk (Jafar, Basuki, Windijarto, & Setiawan, 2024; Mustafa, Chen, Atqa, & Lin, 2025). Additionally, regulatory fragmentation and inconsistent ESG rating frameworks exacerbate the financial disadvantage for firms with limited or low-quality disclosure, as lenders struggle to evaluate risk accurately (MDPI Systems, 2025). Collectively, these findings indicate that the absence of robust ESG or climate reporting can result in restricted access to credit, smaller loan sizes, higher interest rates, and stricter collateral requirements, creating a pronounced gap between disclosure-ready SMEs and those that do not disclose.

3. Methodology

This study adopts an overview research approach to examine the challenges faced by SMEs in adopting IFRS S2 climate disclosure standards and the potential financing barriers arising from non-disclosure. The research method involves a systematic review of relevant literature, reports, and official publications from academic journals, international organizations, and professional institutions. Key sources include the IFRS Foundation, OECD, ACCA, ISSB, and peer-reviewed journal articles focusing on SME sustainability reporting, climate disclosure, and access to finance.

The review process consists of three stages: (1) Identification, where relevant publications and reports from 2020–2025 were collected using keyword searches such as “IFRS S2,” “SME climate disclosure,” “ESG reporting,” and “SME financing barriers”; (2) Screening, where sources were evaluated for relevance, credibility, and applicability to the research focus; and (3) Synthesis, where findings were organized thematically according to the key issues of SME awareness and understanding, incentives to disclose, and financing challenges related to non-disclosure.

The study emphasizes comparative and interpretive analysis, highlighting patterns, gaps, and inconsistencies in existing research and practice. This approach allows the identification of critical issues affecting SME engagement with IFRS S2 and the implications for financing, without collecting primary data. References are drawn from both global and regional contexts to ensure comprehensive coverage and relevance. By using this methodology, the research provides a structured overview of current evidence on SME climate disclosure, offering insights into capacity gaps, incentive structures, and financial risks that inform policy recommendations and future research directions.

4. Results

The literature review reveals three major findings regarding SME engagement with IFRS S2 climate disclosures. SMEs generally exhibit limited awareness and comprehension of climate disclosure standards. Many smaller firms struggle to interpret technical terminology, gather high-quality climate data, and implement reporting processes due to constrained internal expertise and limited resources (IFRS Foundation, 2025; OECD, 2025; Verawaty, Gunawan, & Nuryatno, 2025; Setiawan et al., 2025). This knowledge gap persists across regions, underscoring the challenges SMEs face in aligning with global sustainability reporting requirements. Despite the global adoption of IFRS S2, SMEs frequently perceive climate

disclosure as burdensome, with minimal tangible benefits such as reduced financing costs, faster loan approvals, or reputational gains (Agustini & Arifa, 2024; Wahyuni, 2025; de Bortoli et al., 2025; ACCA, 2025). Even with amendments aimed at simplifying Scope 3 reporting, the absence of explicit financial or regulatory incentives limits voluntary participation in climate reporting. SMEs that fail to disclose climate or ESG information face increased financing risks. Non-disclosure is associated with higher perceived credit risk, restricted loan access, smaller loan sizes, higher interest rates, and stricter collateral requirements (Jafar, Basuki, Windijarto, & Setiawan, 2024; Mustafa, Chen, Atqa, & Lin, 2025; MDPI Systems, 2025; OECD, 2024; SEED, 2024; ICC, 2024). This creates a noticeable divide between disclosure-ready SMEs and non-disclosure SMEs, reflecting both operational and financial vulnerabilities.

5. Discussion

The results indicate that SME capacity, incentives, and disclosure practices are interrelated factors that significantly influence engagement with IFRS S2. The limited awareness and technical understanding of climate reporting standards suggest a persistent capacity gap in the SME sector. SMEs' difficulties in operationalizing IFRS S2 highlight the need for tailored guidance and capacity-building initiatives (IFRS Foundation, 2025; Setiawan et al., 2025). The lack of perceived incentives further reinforces non-disclosure. SMEs may view climate reporting as a regulatory or administrative burden rather than a value-adding activity, reducing motivation to engage even when simplified reporting pathways are available (Agustini & Arifa, 2024; Wahyuni, 2025). Addressing this gap requires not only clarifying the benefits of disclosure but also providing financial, operational, and reputational incentives that make compliance advantageous. The review also emphasizes the financial consequences of non-disclosure. Lenders increasingly integrate ESG and climate performance into credit assessments, and SMEs that fail to provide credible information are often perceived as higher-risk borrowers, resulting in constrained financing terms (Jafar, Basuki, Windijarto, & Setiawan, 2024; Mustafa, Chen, Atqa, & Lin, 2025). This reinforces the link between climate disclosure and access to finance, illustrating how regulatory compliance and financial performance are intertwined for SMEs. Collectively, these findings suggest that enhancing SME readiness, clarifying incentives, and promoting standardized IFRS S2 disclosure practices are critical to bridging the gap between disclosure-ready and non-disclosure SMEs. Policymakers, standard-setters, and financial institutions must collaborate to provide supportive frameworks, technical assistance, and incentive mechanisms to facilitate SME participation in climate reporting, thereby reducing perceived credit risk and promoting equitable access to sustainable finance.

Acknowledgements

The authors would like to express their sincere gratitude to the Faculty of Accountancy, Universiti Teknologi MARA, Shah Alam, Selangor, Malaysia, and the Faculty of Business and Accountancy, Universiti Poly-Tech Malaysia, Kuala Lumpur, Malaysia, for their valuable support and guidance throughout the preparation of this research. The facilities, academic resources, and constructive feedback provided by both institutions have been instrumental in facilitating the completion of this study. The authors also wish to acknowledge the encouragement and insights from colleagues and staff members who contributed, directly or indirectly, to the development of this manuscript.

Conflict of Interest Statement

The authors declare that there is no conflict of interest regarding the publication of this study.

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