



SASB EXPOSURE DRAFT

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Revision:

CONCEPTUAL FRAMEWORK

The Sustainability Accounting Standards Board

The SASB issued this Exposure Draft to solicit public comment on the Conceptual Framework that will guide its post-provisional standard-setting activities. Individuals can submit written comments, in the form of a letter on official letterhead, to comments@sasb.org.

SUMMARY AND QUESTIONS FOR RESPONDENTS

Introduction

The SASB Conceptual Framework is designed to set out the fundamental principles that guide SASB's work. The Conceptual Framework document is a companion to the SASB Rules of Procedure, which outlines the processes and practices that govern SASB's standards-setting activities.

Rationale

In 2012, the Sustainability Accounting Standards Board launched an ambitious undertaking to develop provisional sustainability accounting standards for 10 sectors and 79 industries. During this provisional phase, the SASB's work was guided by a set of principles and processes outlined in the SASB Conceptual Framework.

In March of 2016, the SASB will release provisional standards for its 10th and final sector, marking the end of the 44-month provisional phase and the beginning of a new "post-provisional" stage of standards development. The post-provisional phase has a new objective: to codify the standards (the code will represent the source of authoritative SASB standards) and maintain them into the future. This transition requires a new set of processes and practices for the SASB as a standards-setting organization, which are established in its Rules of Procedure. With the publication of the proposed Rules of Procedure, the Conceptual Framework has been revised to focus solely on the basic principles, concepts, and definitions that guide the SASB and its approach to setting standards for sustainability accounting.

Overview of Key Revisions

As evidenced by this Exposure Draft, updates to the Conceptual Framework include:

- Clarification of the SASB's core objectives of facilitating disclosures that are material, decision-useful, and cost-effective;
- Clarification of the fundamental tenets of the SASB's approach to standards-setting: evidence-based, market-informed, and industry-specific.
- Clarification of the SASB's perspectives on sustainability, materiality, and third-party assurance;
- Simplification of the organization of the content and introduction of a relational model of the various concepts contained therein; and
- Edits for clarity, consistency, and precision, particularly of content related to legal and accounting concepts.
- Removal of information related to the standards development process, which is now included in the companion document, the SASB Rules of Procedure.

Question(s) for Respondents

1. Do you find this Conceptual Framework understandable? If not, which particular section(s) of this document do you find difficult to understand? Do you have suggestions on how to make those sections clearer?
2. Does the discussion in Section 1 of this Conceptual Framework appropriately and clearly answer each of the five fundamental questions? If not, why not? Are there any other fundamental questions you believe need to be discussed in this section?
3. Are the principles and criteria discussed in Section 4 of this Conceptual Framework sufficient to produce outcomes that meet SASB's core objectives (i.e., disclosures that are material, decision-

useful, and cost-effective)? If not, why not? Are there any other principles or criteria you believe SASB should consider when selecting topics and/or metrics?

4. Are there any other matters or issues that you believe the SASB should consider in finalizing the revisions to its Conceptual Framework?



CONCEPTUAL FRAMEWORK

OF THE SUSTAINABILITY ACCOUNTING
STANDARDS BOARD

DRAFT



April 2016

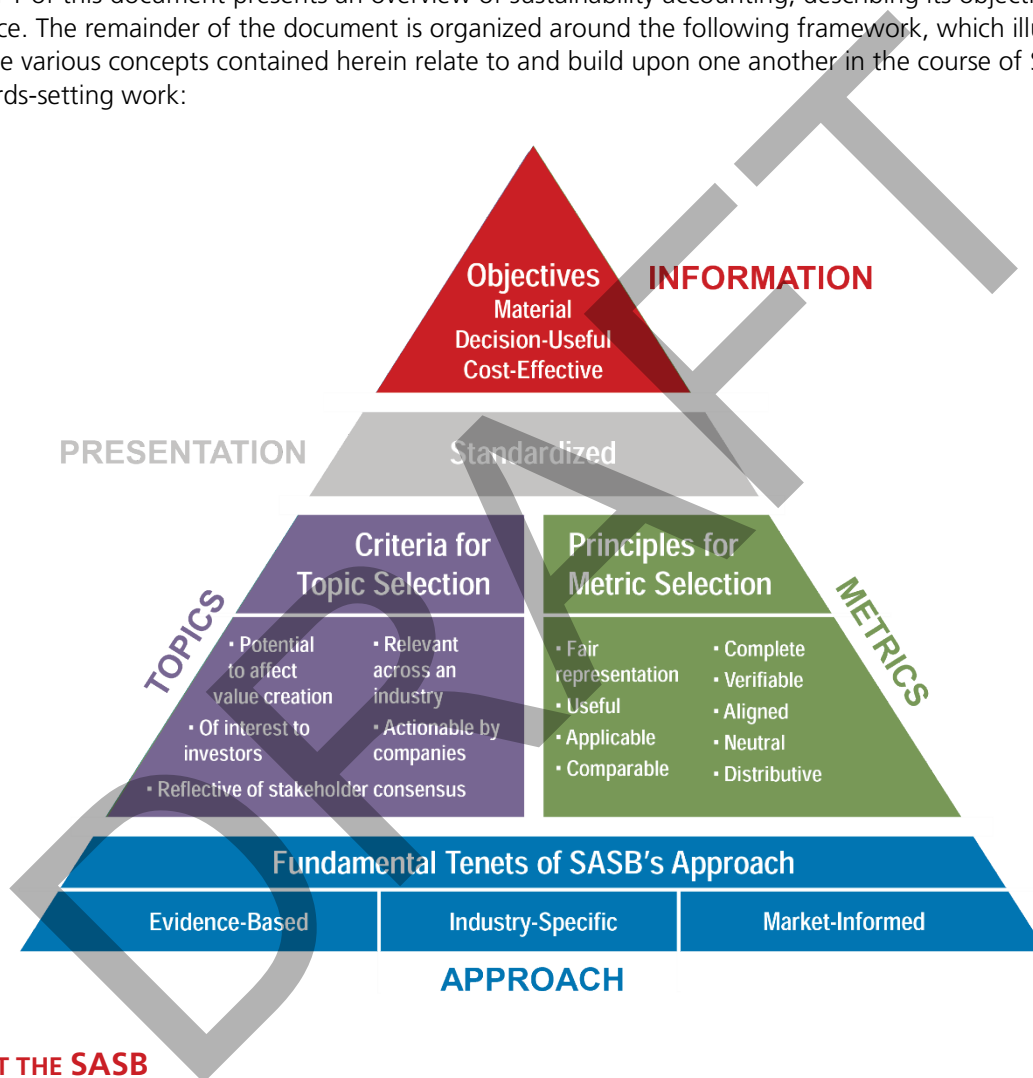
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Introduction

This Conceptual Framework sets out the basic concepts, principles, definitions, and objectives that guide the Sustainability Accounting Standards Board in its approach to setting standards for sustainability accounting. A companion document, the SASB Rules of Procedure, is focused on the governance processes and practices for standard setting. Together, these documents provide direction for the SASB and its work.

Section 1 of this document presents an overview of sustainability accounting, describing its objectives and audience. The remainder of the document is organized around the following framework, which illustrates how the various concepts contained herein relate to and build upon one another in the course of SASB’s standards-setting work:



ABOUT THE SASB

The Sustainability Accounting Standards Board (SASB) is an independent 501(c)(3) nonprofit organization and is an American National Standards Institute (ANSI) accredited standards developer.¹ SASB’s mission is to develop and disseminate sustainability accounting standards that help public corporations disclose material, decision-useful information to investors. That mission is accomplished through a rigorous process that includes evidence-based research and balanced stakeholder participation. The SASB standards are designed for voluntary use in making disclosures required by existing U.S. regulation in filings with the Securities and Exchange Commission (SEC), such as Forms 10-K and 20-F.

¹ Nota bene: At time of publication, SASB has not formed a Consensus Body or declared its intent to develop an American National Standard through the ANSI Project Initiation Notification System (PINS).

1. Overview of Sustainability Accounting and Disclosure

In developing the first set of sustainability accounting standards for the U.S. capital markets, the SASB addresses a set of fundamental questions:

- What is sustainability accounting?
- What is the purpose of sustainability accounting?
- How does it differ from financial accounting?
- Who is its intended audience?
- How will it be used?

SUSTAINABILITY ACCOUNTING

The concept of sustainability or sustainable development is defined in the Brundtland Report (*Our Common Future*) as “development that meets the needs of the present without compromising the ability of future generations to meet their own needs.”²

For the purpose of the SASB standards, sustainability refers to *corporate activities that maintain or enhance the ability of the company to create value over the long term*. Sustainability accounting refers to the measurement, management, and reporting of such corporate activities.

Sustainability accounting reflects the management of a corporation’s environmental and social impacts arising from production of goods and services, as well as the management of the environmental and social capitals necessary to create long-term value. It also includes the impacts that sustainability challenges have on innovation, business models, and corporate governance and vice versa.

Therefore, the SASB’s sustainability topics are organized under five broad sustainability dimensions:

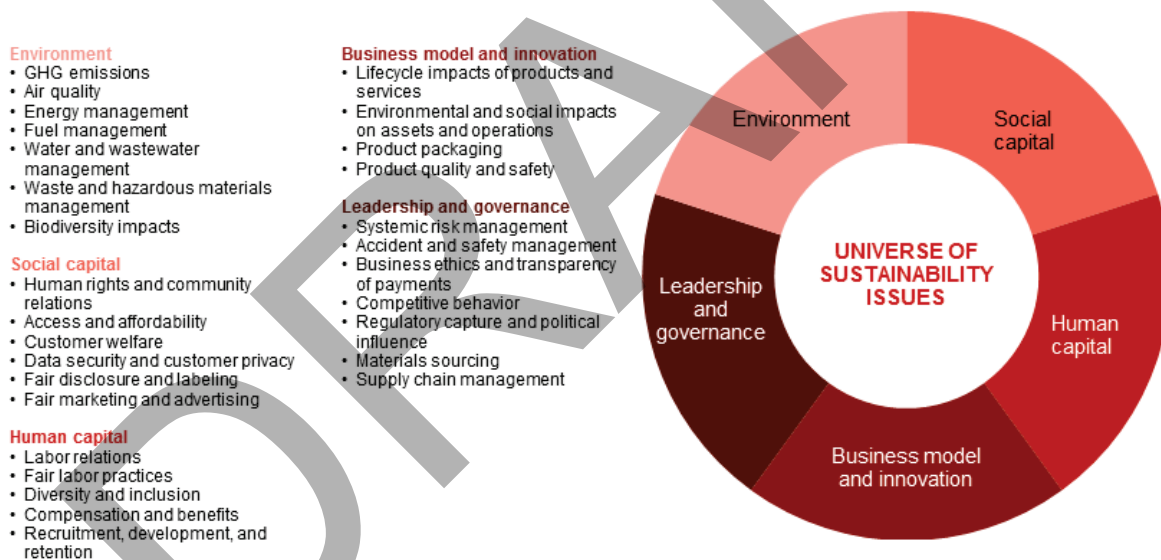
1. **Environment.** This dimension includes corporate impact on the environment, either through the use of nonrenewable, natural resources as input to the factors of production (e.g., water, minerals, ecosystems, and biodiversity) or through environmental externalities or other harmful releases in the environment, such as air and water pollution, waste disposal, and greenhouse gas (GHG) emissions.
2. **Social Capital.** This dimension relates to the perceived role of business in society, or the expectation of business’s contribution to society in return for a social license to operate. It addresses the management of relationships with key outside parties, such as customers, local communities, the public, and the government. It includes issues around access to products and services, affordability, responsible business practices in marketing, and customer privacy.
3. **Human Capital.** This dimension addresses the management of a company’s human resources (employees and individual contractors) as a key asset to delivering long-term value. It includes issues that affect the productivity of employees, such as employee engagement, diversity, and incentives and compensation, as well as the attraction and retention of employees in highly competitive or constrained markets for specific talent, skills, or education. It also addresses the management of labor relations in industries that rely on economies of scale and compete on the price of products and services, and in industries with legacy pension liabilities. Finally, it includes the management of the health and safety of employees and the ability to create a safety culture for companies that operate in dangerous working environments.

² United Nations World Commission on Environment and Development, *Our Common Future* (Oxford: Oxford University Press, 1987), p. 43.

4. **Business Model and Innovation.** This dimension addresses the impact of sustainability issues on innovation and business models. It addresses the integration of environmental, human, and social issues in a company’s value-creation process, including resource efficiency and other innovations in the production process, as well as product innovation, including efficiency and responsibility in the design, use phase, and disposal of products. It also includes management of environmental and social impacts on tangible and financial assets—either a company’s own or those that it manages as the fiduciary for others.
5. **Leadership and Governance.** This dimension involves the management of issues that are inherent to the business model or common practice in the industry and that are in potential conflict with the interest of broader stakeholder groups (government, community, customers, and employees), and therefore create a potential liability or, worse, a limitation or removal of a license to operate. This includes regulatory compliance, lobbying, and political contributions. It also includes risk management, safety management, supply-chain and resource management, conflict of interest, anticompetitive behavior, and corruption and bribery, as well as the risk of complicity in human rights violations.

In developing its provisional standards, the SASB identified sustainability topics from an initial set of 30 broadly relevant sustainability issues (see Figure 1, below) organized under these five broad sustainability dimensions.

Figure 1: The SASB Universe of Sustainability Issues



Although the “universe” of sustainability issues served as a starting point for SASB’s provisional standard-setting, this extensive list was refined through a series of steps designed to identify those issues reasonably likely to have material impacts on companies in an industry. Because each of these issues tends to have a different impact or consequence depending on the context in which it arises, sustainable corporate activities will vary from one industry to another, meaning each industry therefore has its own unique sustainability profile.

PURPOSE OF SUSTAINABILITY ACCOUNTING AND DISCLOSURE

Market value typically differs from book value, in part, because traditional financial statements do not necessarily capture all of the factors that contribute to a company’s long-term ability to create value. Much of this “value gap” is attributable to, or can be significantly impaired by the management or mismanagement of, environmental, social, and human capitals as well as corporate governance and opportunities for

innovation. Therefore corporate reporting must extend beyond financial statements to facilitate the measurement and reporting of sustainability information that will enhance a decision makers' understanding of all material risks and opportunities. Like financial accounting, sustainability accounting has both confirmatory and predictive value, so it can be used to evaluate past performance as well as for future planning and decision support. As a complement to financial accounting, it helps provide a more complete view of a corporation's performance and its ability to create long-term value.

Financial accounting addresses some elements of sustainability performance. However, financial accounting is intended, for the most part, to reflect an entity's current state. Furthermore, attempting to account for sustainability performance in financial terms is inherently limited by the absence of proper valuation techniques and/or adequate market pricing. While environmental, human, and social capitals can be understood conceptually as economic assets and liabilities, they are difficult to "price" adequately, either in terms of historical costs and prices or in terms of current market prices or fair values.

Therefore the SASB's approach to sustainability accounting consists of defining non-financial metrics—both qualitative and quantitative—on industry-specific sustainability topics likely to be of interest to investors and creditors, thereby helping to communicate and to more completely represent company performance. Like financial accounting information, sustainability information captures past and current performance, and can also be forward-looking to the extent that it helps management describe known trends, events, and uncertainties³ that may reveal an actual or potential impact on the financial condition or operating performance of a reporting entity.

Thus, sustainability accounting facilitates a more complete understanding of the fundamentals of a reporting entity. For example, such impacts may result from:

- Management of critical capitals necessary for production of goods or services;
- Vulnerability to depletion or misuse of these capitals;
- Exposure to new or existing regulation or changing societal norms
- Scenario-planning regarding alternative resources or business models;
- Risks associated with mismanagement of certain environmental, social, or governance issues; and
- Opportunities associated with global or industry sustainability challenges.

The SASB believes that, over time, accounting for sustainability performance will give investors a more complete view of the outlook and ability of a corporation and/or entire industry to sustain value creation, and an ability to better compare and distinguish among the corporations in a given industry based on their strategies and operations with respect to these issues.

USERS OF SUSTAINABILITY ACCOUNTING STANDARDS

The SASB standards are intended for voluntary use by public companies in making disclosures that are required by existing U.S. regulation, including those in Forms 10-K and 20-F. They are a market-driven response to the need for sustainability information that is decision-useful for investors and cost-effective for issuers.

The SASB standards may also be applicable to disclosure of material sustainability information by other types of organizations, including privately held corporations and foreign corporations publicly listed in other jurisdictions.

³ Regulation S-K, CFR §229.303 – Item 303, Management's discussion and analysis of financial condition and results of operations

Corporations have many important stakeholders and a variety of channels through which they may communicate sustainability information, including websites, sustainability reports, and corporate social responsibility reports. However, the SASB standards are developed for use in statutory filings for the benefit of investors and others who rely on such filings.

BENEFICIARIES OF SUSTAINABILITY ACCOUNTING STANDARDS

Investors

U.S. securities laws seek to protect investors by requiring companies whose securities are registered with the SEC to provide annual and other periodic filings that are necessary for a “reasonable investor” to make informed investment decisions. (See the definition of “materiality” in Section 2). Similarly, SASB standards are intended to help investors make informed decisions. As changes occur in the broader economy, the information markets need to efficiently allocate capital may also change in ways that may require, public companies to adjust their disclosures.⁴ SASB standards are intended to help issuers identify and disclose the information investors need to make informed decisions.

As of 2015, more than 1,400 organizations with \$59 trillion in assets under management were signatories to the Principles for Responsible Investment, indicating a commitment to incorporate sustainability issues into investment analysis and decision-making processes.⁵ However, achieving the objectives of the Principles is hindered by a lack of comparable, decision-useful data and information about these issues. Even when such information is available, culling it from current reports can require substantial time and expense for investors.

The SASB’s mission is to facilitate effective disclosure of material sustainability information in SEC filings so that investors have access to the sustainability information that is necessary to make informed investment decisions with reasonable effort and minimal expense.

The SASB standards and other products are designed to support investors in their efforts to integrate sustainability information into core activities, such as the following:

- **Fundamental analysis:** The availability of sustainability fundamentals alongside financial fundamentals provides the data needed to adjust equity and debt valuation models, as well as evaluate management quality for individual securities selection.
- **Comparison and benchmarking:** The data that results from thousands of publicly traded companies disclosing standardized, industry-specific sustainability accounting metrics will enable investors to perform peer-to-peer comparisons on critical dimensions of sustainability performance and establish industry benchmarks against which issuers can be compared.
- **Portfolio management:** The SASB’s Sustainable Industry Classification System™ (SICS™) groups industries with similar business models and sustainability impacts. The SASB standards identify sustainability topics that are reasonably likely to constitute material information for companies within a specific industry. Together, SICS™ and the industry-specific disclosure topics will help investors to identify and manage under- or overexposure to certain types of sustainability risks and opportunities.
- **Active engagement:** Investors and companies can use the SASB standards—and the information they yield—to guide conversations, resulting in more focused, more productive engagements on material sustainability factors.

Companies

An increasing number of companies have begun reporting on sustainability issues in voluntary, stand-alone reports on corporate social responsibility (CSR) or sustainability. Indeed, 71 percent of the top 100 companies

⁴ Business Roundtable, “[The Materiality Standard for Public Company Disclosure: Maintain What Works](#)” (October 2015)

⁵ Principles for Responsible Investment website, <http://www.unpri.org>, accessed Dec. 22, 2015

in 41 countries reported on sustainability factors in 2013,⁶ 95 percent of the largest 250 companies in the world produced a sustainability report in 2011,⁷ and by 2016 more than 12,000 companies had produced more than 70,000 reports globally.⁸

However, these reports are costly to produce and lack focus on the sustainability issues that are of most interest to investors, namely those most likely to have material impacts on a company's financial condition or operating performance. As a result, companies also field requests for sustainability information in the form of surveys and questionnaires from investors and ratings agencies, creating a significant burden on the issuer with limited benefit to its shareholders.⁹

By focusing on the subset of sustainability factors that are likely to have material impacts, SASB standards yield information that may be useful to a company's management while also providing a cost-effective solution for disclosure to investors. Academic research has shown that such a focus is correlated with outperformance in terms of sales, sales growth, return on assets, and return on equity in addition to improved risk-adjusted shareholder returns.¹⁰ The SASB metrics can enhance or be incorporated into companies' performance evaluation systems to promote goal congruence and coordination, communicate expectations, motivate business units, provide feedback to top-level decision-makers, and inform benchmarking efforts. They can help managers identify those operations that are falling short of expectations, and to focus their attention on what needs improvement.

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⁶ KPMG, "The KPMG Survey of Corporate Responsibility Reporting 2013" (2013)

⁷ EY, "Value of Sustainability Reporting" (2014)

⁸ Corporate Register website, <http://www.corporateregister.com>, accessed Jan. 1, 2016

⁹ Ann Klee, "Ratings Good for the Environment?" *Environmental Forum* (May/June 2015)

¹⁰ Mozaffar Khan, George Serafeim, and Aaron Yoon, "Corporate Sustainability: First Evidence on Materiality," Harvard Business School (March 2015)

2. Core Objectives of the SASB

The SASB is committed to facilitating more effective disclosure of material sustainability information by issuers to investors. This section lays out the core objectives guiding the SASB's work as a standard setter. SASB's due process is designed to produce standards for information that:

- Is reasonably likely to be **material**
- Is **decision-useful** for companies and their investors
- Is **cost-effective** for corporate issuers

SASB STANDARDS IDENTIFY INFORMATION THAT IS LIKELY TO BE MATERIAL

SASB standards address the sustainability topics that are reasonably likely to have material impacts on the financial condition or operating performance of companies in an industry. *The SASB recognizes that each company is ultimately responsible for determining what information is material and what information should be included in its SEC filings.* In identifying sustainability topics that are reasonably likely to have material impacts, the SASB applies the definition of "materiality" under the U.S. securities laws.

According to the U.S. Supreme Court, information is material if there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."¹¹

A duty to disclose material sustainability information may arise under the requirements of Regulation S-K. Regulation S-K, which sets forth the specific disclosure requirements associated with Form 10-K and other SEC filings, requires that companies describe known trends, events, and uncertainties that are reasonably likely to have material impacts on their financial condition or operating performance in the Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) section of Form 10-K or 20-F.

The MD&A requirement calls for companies to provide investors and other users with material information that is necessary to form an understanding of the company's financial condition and operating performance, as well as its prospects for the future.¹² The SEC's interpretive guidance on disclosure requirements related to climate change and cybersecurity highlight the applicability of other Form 10-K sections, namely the description of business (§ 229.101), and risk factors (§ 229.503(c)).^{13,14} SASB standards help issuers identify sustainability topics that, substantiated by evidence, constitute known trends, events, and uncertainties that are reasonably likely to have material impacts on companies in an industry.

SASB STANDARDS YIELD DECISION-USEFUL INFORMATION

SASB standards provide investors with decision-useful information on the sustainability issues that are reasonably likely to materially affect near-, medium-, or long-term business value. The decision-usefulness of sustainability information is enhanced when it is representationally fair, comparable, complete, verifiable, neutral, and distributive. (See Page 13.)

For each topic identified in an industry, the SASB identifies decision-useful accounting metrics to account for company performance on the topic. Accounting metrics address sustainability impacts, as well as

¹¹ TSC Indus. v. Northway, Inc., 426 U.S. 438, 449 (1976)

¹² SEC, FR-72, Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations (December 2003)

¹³ SEC, Commission Guidance Regarding Disclosure Related to Climate Change (February 2010)

¹⁴ CF Disclosure Guidance: Topic No. 2 Division of Corporation Finance guidance regarding disclosure obligations relating to cybersecurity risks and cyber incidents (October 2011).

opportunities for innovation. Taken together, they characterize a company's positioning with respect to sustainability issues and the potential for long-term value creation.

Public disclosure using the SASB's sustainability accounting standards facilitates:

- Peer-to-peer comparison and benchmarking of corporate performance on key sustainability issues;
- More focused efforts by companies to manage risk and improve performance on key sustainability issues;
- A comprehensive view of material sustainability risks and opportunities for investors;
- Integrated presentation of financial statements and material sustainability information allowing investors to better understand performance in context;
- Public access to regularly reported sustainability data via SEC filings and the SEC EDGAR database; and
- Sustainability information that is reliable, trustworthy, and verifiable.

SASB STANDARDS ARE COST-EFFECTIVE FOR CORPORATE ISSUERS

SASB standards are designed to provide a cost-effective way for companies to disclose material, decision-useful sustainability information to investors. The SASB achieves this objective in two key ways:

1. Because they focus on only those sustainability issues that are reasonably likely to have material impacts, the SASB standards identify the minimum set of topics for consideration in each industry, the majority of which are already addressed in SEC filings by many public companies in some fashion.¹⁵
2. A significant percentage of the metrics in the SASB standards are aligned with initiatives already in use. As part of its standards-development process, the SASB identifies and documents existing metrics and practices used to account for performance on each disclosure topic. When possible, the SASB harmonizes its standards with existing metrics, definitions, frameworks, and management disclosure formats, thereby minimizing the corporate reporting burden.

Use of the SASB metrics may also mitigate the need for the costly and time-consuming questionnaires that investors, analysts, and ratings groups frequently use to obtain sustainability information.

¹⁵ SASB research shows that 74 percent of SASB disclosure topics have been addressed in SEC filings. However, of those disclosures, more than 40 percent use boilerplate language while only 15 percent include metrics.

3. Fundamental Tenets of the SASB Approach to Standard-Setting

The SASB takes a systematic approach to its standard-setting activities to ensure that its standards identify industry-specific sustainability factors that are likely to have material impacts, while also providing disclosure guidance that is cost-effective for issuers and decision-useful for investors. To achieve these objectives, SASB standards are:

- Evidence-Based
- Market-Informed
- Industry-Specific

EVIDENCE-BASED

The SASB takes an evidence-based approach to assess the likelihood of material impacts from sustainability topics. This approach considers evidence of interest to investors and evidence of financial impact, the two principal types of evidence that the SEC has used as a basis for rulemaking related to disclosures. In analyzing sustainability topics, the SASB looks for the presence of both types of evidence, identifying topics that might be of interest to the reasonable investor and assessing their potential for financial impact.

This method enables a relative prioritization of sustainability topics relevant to investors and suitable for inclusion in companies' SEC filings; it is an indication that a standardized form of disclosure is warranted, but it is not a determination of materiality. This process allows for an understanding of which issues are most important to address in standard setting. It also ensures that SASB standards are kept to a minimum set of topics that are reasonably likely to constitute material information.

Evidence of Interest to a Reasonable Investor

The SASB assesses the likely materiality of sustainability topics by looking at evidence of interest from the perspective of a reasonable investor.

Evidence of interest to a reasonable investor is assessed along five dimensions:

1. **Financial Impacts & Risk:** This factor assesses the likelihood that corporate performance on the topic will have a direct and measurable impact on near- or medium-term financial performance.
2. **Legal, Regulatory & Policy Drivers:** Existing, changing, or emerging regulation may influence company actions and affect financial performance by forcing the internalization of certain costs associated with compliance and/or by creating upside opportunity associated with new products, markets, or business models that become viable under a different regulatory regime.
3. **Industry Norms & Competitive Drivers:** Peer actions and disclosure on industry issues may create investor pressure for higher standards of performance related to the management and disclosure of certain sustainability topics.
4. **Stakeholder Concerns & Social Trends:** Stakeholders may raise concerns that could influence medium- or long-term financial or operating performance or create acute short-term financial impacts through loss of license to operate, reputational damage, changes in customer demand, and disruptions to business viability.
5. **Opportunities for Innovation:** New products and business models to address industry sustainability challenges can drive market expansion or have the potential for a disruptive change

that provides new sources of competitive advantage. Financial impacts and risks associated with these innovations may be of interest to investors.

Evidence of Financial Impact

The SASB assesses the actual or potential impact of sustainability issues on the financial condition or operating performance of companies. The SASB considers whether management (or mismanagement) of the topic has the potential to materially affect the valuation of a company or its operational or financial performance.

The SASB conducts extensive research to identify evidence of financial impact associated with sustainability issues, and relies on robust and diverse sources of credible evidence that support different types of financial impacts. The SASB primarily analyzes two types of information: (i) industry-level and (ii) company-specific.

Industry-level information provides the financial and regulatory context in which companies in that industry operate, as well as context on how the industry as a whole is affected by, or impacts, sustainability issues (e.g., large contributors to greenhouse gases, industries with high injury or fatality rates). This information is drawn from credible sources such as databases of U.S. government agencies (environmental, safety data), industry research products, academic studies, and financial publications, among others. The SASB conducts additional analysis of data where necessary, to assess industry performance relative to other industries and over time.

Company-specific information provides tangible examples of actual or potential impact on company valuation or financial performance resulting from sustainability issues (e.g., large or frequent fines faced by companies, cost savings through implementation of energy efficiency measures, reputational and market damage from customer or stakeholder action). This information is derived from company reporting through sustainability reports and websites as well as regulatory filings, news media, and case studies from NGOs and research organizations, among others.

Taken together, this information provides an overall picture of whether the management or mismanagement of the topic has the potential to affect the valuation or operational or financial performance of most companies in an industry. As far as possible, in order to ensure that the disclosure topics identified are relevant for an industry over time, the SASB evaluates evidence based on the underlying industry structure, regulatory environment, and financial drivers of an industry, and by focusing on long-term trends rather than anecdotal impacts from a specific corporation. This research is supplemented by evaluating the current state of affairs in an industry or sector, to ensure emerging sustainability topics are included in the standards as they become relevant.

In conducting its research, the SASB identifies specific types of financial impacts, namely revenues and costs, assets and liabilities, and/or the cost of capital.

- **Revenue/cost:** Projected revenue, earnings, market share, and/or pricing power can be impacted by material sustainability factors. Costs can be impacted by operational efficiency (energy, labor, supply chain), by investments needed for compliance with sustainability-related regulation, or through the availability or price of raw materials or other inputs for production.
- **Assets/liabilities:** Sustainability factors can affect both tangible assets and intangible assets. For example, water scarcity can impair agricultural and grazing land as well as nearby processing facilities, while labor and community relations can impact brand value. Liabilities can also be impacted by weather-related events, while litigation and regulatory actions related to sustainability issues can create contingent liabilities.
- **Risk profile:** A company's financial condition and market valuation can be impacted by sustainability factors through the increased cost of capital or limited access to capital. Better disclosure enables a

more complete understanding of exposure to risk and more accurate pricing of risk associated with volatile performance and/or industries with an unstable outlook.

The financial impact of sustainability issues can be actual or potential, positive or negative, chronic or acute, and priced or unpriced. Actual impacts, for example, might materialize in the form of existing regulation requiring CAPEX or current shifts in consumer demand. Potential impacts may arise from pending regulation on sustainability issues or from threats of competition for market share or capital. Acute impacts may result from a catastrophic event such as an unplanned environmental discharge or breach of customer privacy or safety. Acute impacts affect price in the short term and are often predicated by poor records of managing these types of risks when compared to industry norms. Chronic impacts can include the long-term erosion of value associated with an asset that may be stranded in the face of regulation (oil reserves, for example) and/or the threat of divestment from investors. Risks that are priced are generally well disclosed and are better understood by investors. Risks that are unpriced are generally undisclosed or poorly disclosed. SASB maintains a record of the current state of 10-K disclosure on SASB topics in its Industry Research Briefs.

When assessing sustainability issues with the potential for material financial impact, the SASB takes into account the two-part test that the SEC has established to determine whether trends, demands, commitments, events, or uncertainties should be disclosed in the MD&A section of Form 10-K:

- A reasonable likelihood that the known trend, demand, commitment, event, or uncertainty will occur; and
- A reasonable likelihood that the occurrence will have a material effect on the registrant's financial condition or results of operations.

MARKET-INFORMED

Although evidence-based research provides a foundation for the SASB's standard-setting process, the outcomes are shaped in large part by feedback from participants in the capital markets—i.e., corporate issuers and mainstream investors. The SASB actively solicits input and carefully weighs all stakeholder perspectives in considering which aspects of a sustainability topic warrant standardized disclosure and in determining how to frame, describe, and measure those aspects for the purposes of standardization. However, although the SASB considers the views of all stakeholders, its determinations are guided by its core objectives to provide the users and providers of financial capital with material, decision-useful, cost-effective disclosures.

As part of the SASB's due process, its provisional standards have undergone vetting by a group of industry experts, comprised of a balanced group of one-third corporate professionals, one-third investors, and one-third other stakeholders. The SASB aims to consider sustainability topics for standard-setting when consensus among issuers and investors indicates that the topic is reasonably likely to have a material impact on most companies in the industry. Furthermore, the SASB solicits feedback from industry experts to evaluate how well its proposed metrics meet the criteria outlined in Section 4, and incorporates input as appropriate before issuing new standards or updates to standards.

Informed by ANSI's Essential Requirements, the SASB's standards codification and maintenance process is guided by market feedback in that it is transparent, open to public comments, and governed by a Standards Council comprised of balanced representation from each of the three affected stakeholder categories (i.e., investors, issuers, and intermediaries).

Finally, the SASB engages in ongoing consultation with both issuers and investors to ensure the maintenance of decision-useful, cost-effective standards. As changes occur in an industry's competitive context, in the broader sustainability landscape, or in the interests of the reasonable investor, this bottom-up, market-based approach is key to ensuring that the SASB standards evolve to support market needs.

INDUSTRY-SPECIFIC

Analyzing the materiality of sustainability information requires an understanding of the specific impact of business on society and the environment, as well as the impact of sustainability challenges on business. Companies operating in a specific industry are more likely than companies in disparate industries to have similar business models and use resources in similar ways. Therefore they are likely to have similar sustainability risks and opportunities. The SASB develops sustainability accounting standards at the industry level, focusing on issues that are closely tied to resource use, business models, and other factors at play in the industry. As a result, financial analysts, who also evaluate corporate performance within an industry context, can easily integrate and assess material sustainability factors alongside financial fundamentals.

Traditional industry classification systems present a challenge to SASB's industry focus because they do not always group industries with common sustainability characteristics. In addition, traditional classification systems establish hierarchies and layers of industries based on revenue and other economic variables, providing less visibility—and access to capital—for industries with greater sustainability risks or opportunities but smaller economic footprints.

To address this issue, the SASB developed SICSTM, which builds on traditional classification systems (e.g., SIC, GICS, and BICS) and categorizes sectors and industries in accordance with a fundamental view of their business models, their resource intensity and sustainability impacts, and their sustainability innovation potential. SICSTM classification of individual companies can be publicly accessed at www.sasb.org using company ticker symbols.

Systemic Sustainability Issues

Certain prominent sustainability issues, such as climate change, water use, human capital, and political contributions, generate great interest from a variety of parties, including the media, the public, government agencies, nongovernmental organizations, and investors. However, the SASB subjects these issues to the same evidence-based, market-informed approach used for all potential disclosure topics.

Through its industry focus, the SASB systematically assesses the relevance of each topic and the potential for material impacts on companies in each SICSTM industry. This ensures that topics recommended for disclosure are included in the standards on the basis of evidence amassed in an industry context as well as input from a balanced group of industry experts.

When topics are determined to be reasonably likely to have material impacts in more than one industry, they are referred to as cross-cutting issues. However, from one industry to the next, the SASB may recommend different approaches to the disclosure of information related to these topics. This is because general sustainability topics often have unique impacts on different business models, and analysts may need industry-specific performance metrics to assess risk and/or future outlook. For example, climate risk is present in many industries, but the performance metrics are often unique. In real estate, investors are interested in the vulnerability of assets and the quality of building stock. In health care, event preparedness and business continuity risk is important, as are changing disease migration patterns. In oil and gas, the carbon intensity of reserves and current emissions are important to assess fundamental and relative risk. SASB evaluates the best metrics to characterize performance on a topic within an industry context. However, consistent treatment of similar issues and similar accounting metrics across industries is preferred whenever possible to make the system more useful to investors with diversified portfolios.

4. Guiding Principles and Criteria for Standards Development

As outlined in Section 3, the SASB's standards-development process is designed to be evidence-based, to include broad stakeholder participation, and to reflect industry-specific sustainability impacts. During this process, a set of principles (at the disclosure topic level) and criteria (at the metric level) guide internal decisions and interactions with external stakeholders who are involved in helping the SASB set industry standards. The principles are used in conjunction with the SASB's core objectives (defined in Section 2) to inform the final selection of topics for which standards are developed within an industry. Meanwhile, the criteria are used to rigorously evaluate the quality of the accounting metrics that are proposed for use in describing corporate performance on a topic, ensuring that they facilitate disclosure of information that is material, decision-useful, and cost-effective.

PRINCIPLES FOR TOPIC SELECTION

The SASB considers the following set of principles when identifying sustainability topics that warrant an industry standard. Each potential topic is evaluated against these principles before being proposed for inclusion in an industry standard, helping to focus the standards on only the most critical sustainability topics.

- **Potential to affect value creation:** Through research and stakeholder input, the SASB identifies topics that can or do affect results of operations and financial conditions through three channels of impact: (1) revenues and costs, (2) assets and liabilities, and (3) risk profile or cost of capital.
- **Of interest to investors.** The SASB develops standards for sustainability topics that are reasonably likely to constitute material information. Topics are selected based on the strength of their relationship to the following five factors: (1) direct financial impacts and risks, (2) legal, regulatory, and policy drivers, (3) industry norms, best practices, and competitive drivers, (4) stakeholder concerns and social impacts, and (5) opportunities for innovation.
- **Relevant across an industry.** The SASB addresses topics that are systemic and/or represent unique risks and opportunities to the industry and, therefore, that are likely to apply to many companies within an industry.
- **Actionable by companies.** The SASB assesses whether broad sustainability trends can be translated into industry-specific topics that are within the control or influence of individual companies.
- **Reflective of stakeholder consensus.** The SASB considers whether there is consensus among issuers and investors that each disclosure topic is reasonably likely to constitute material information for most companies in the industry.¹⁶

CRITERIA FOR ACCOUNTING METRICS

At the level of accounting metrics, the SASB considers the following set of criteria when evaluating potential metrics to measure performance on aspects of each sustainability topic:

¹⁶ During SASB's provisional phase of standard-setting, it formed Industry Working Groups composed of a balanced representation from investors, corporate professionals, and other stakeholders. When a topic failed to reach at least 75 percent consensus that it would likely constitute material information and therefore warrant a standard, it was either flagged for further review (if close to 75 percent) or not carried forward. On average, more than 82 percent of investors and issuers agreed on the likely materiality of the disclosure topics included in the SASB's provisional phase standards. The SASB's standards codification and maintenance process strives for consensus as described in the SASB Rules of Procedure.

- **Fair Representation:** A metric adequately and accurately describes performance related to the aspect of the disclosure topic it is intended to address, or is a proxy for performance on that aspect of the disclosure topic;
- **Useful:** A metric will provide useful information to companies in managing operational performance on the associated topic and to investors in performing financial analysis;
- **Applicable:** Metrics are based on definitions, principles, and methodologies that are applicable to most companies in the industry based on their typical operating context;
- **Comparable:** Metrics will yield primarily (a) quantitative data that allow for peer-to-peer benchmarking within the industry and year-on-year benchmarking for an issuer, but also (b) qualitative information that facilitates comparison of disclosure ;
- **Complete:** Individually, or as a set, the metrics provide enough data and information to understand and interpret performance associated with all aspects of the sustainability topic;
- **Verifiable:** Metrics are capable of supporting effective internal controls for the purposes of data verification and assurance;
- **Aligned:** Metrics are based on those already in use by issuers or are derived from standards, definitions, and concepts already in use by issuers, governments, industry associations, and others
- **Neutral:** Metrics are free from bias and value judgment on behalf of the SASB, so that they yield an objective disclosure of performance that investors can use regardless of their worldview or outlook; and
- **Distributive:** Metrics will yield a discernable range of data for companies within an industry allowing users to differentiate performance on the topic or an aspect of the topic.

5. Elements of Standardized Presentation

Each SASB standard is presented in a structured manner to ensure consistent application and facilitate cost-effective, decision-useful information. Broadly speaking, the SASB standards are composed of (1) disclosure guidance; and (2) sustainability accounting standards on sustainability topics for use by U.S. and foreign public companies in their annual filings with the SEC, such as Form 10-K or 20-F. To the extent relevant, the SASB standards may also be applicable to other filings with the SEC, such as Form 10-Q, Form S-1, and Form 8-K.

More specifically, each SASB standard includes the following standardized elements:

GENERAL DISCLOSURE GUIDANCE

The standard provides general guidance for issuers in using SASB standards, including that on scope, reporting format, timing, limitations, and forward-looking statements. The SASB's disclosure guidance identifies sustainability topics at the industry level, which—depending on specific operating context—may constitute material information for a company within that industry. Each company is ultimately responsible for determining what information is material, and what information the company may be required to disclose in its Form 10-K, Form 20-F, or other SEC filings. Therefore, *the SASB standards are intended as guidance for companies as they perform their own determinations of materiality and disclosure obligations.*

INDUSTRY DESCRIPTION

The standard describes the industry that is the subject of the standard, including any assumptions about the business model and industry segments that are included or not included.

TOPIC AND TOPIC DESCRIPTION

The standard lists and briefly describes how management or mismanagement of the various aspects of the topic may affect value creation.

SUSTAINABILITY ACCOUNTING METRICS

The standard provides companies with standardized quantitative—or, in some cases, qualitative—metrics intended to measure performance on each disclosure topic or an aspect of the topic.

Sustainability accounting metrics should be accompanied by a narrative description of any material factors necessary to ensure completeness, accuracy, and comparability of the data reported, where not addressed by the specific accounting metrics, including strategy, competitive positioning, degree of control, performance, and trends over time.

TECHNICAL PROTOCOLS

For each sustainability accounting metric, technical protocols provide guidance on definitions, scope, accounting guidance, compilation, and presentation that may serve as the basis for “suitable criteria,” defined by the PCAOB's AT Section 101¹⁷ as having the following attributes:

- **Objectivity:** Criteria should be free from bias.
- **Measurability:** Criteria should permit reasonably consistent measurements, qualitative or quantitative, of subject matter.

¹⁷ PCAOB, [AT Section 101](#) – Attest Engagements

- **Completeness:** Criteria should be sufficiently complete so that those relevant factors that would alter a conclusion about subject matter are not omitted.
- **Relevance:** Criteria should be relevant to the subject matter.

ACTIVITY METRICS

The standard includes activity metrics that represent the scale of the issuer's business to provide operational context and to facilitate normalization of SASB accounting metrics, which is important for the analysis of related disclosures.

Such data may include high-level business data such as total number of employees, quantity of products produced or services provided, number of facilities, or number of customers. It may also include industry-specific data such as plant capacity utilization (e.g., for specialty chemical companies), number of transactions (e.g., for Internet media and services companies), hospital bed days (e.g., for health care delivery companies), or proven and probable reserves (e.g., for oil and gas exploration and production companies).

Activity metrics disclosed should:

- Convey contextual information that would not otherwise be apparent from SASB accounting metrics.
- Be deemed generally useful for investors relying on SASB accounting metrics in performing their own calculations and creating their own ratios.
- Be explained and consistently disclosed from period to period to the extent they continue to be relevant.¹⁸

¹⁸ FASB Business Reporting Research Project, *Improving Business Reporting: Insights into Enhancing Voluntary Disclosures* (January 29, 2001)

Appendix: SASB's Sustainable Industry Classification System™ (SICS™)

Where traditional industry classification systems group companies by sources of revenue, SASB's approach considers the resource intensity of firms, and groups industries with like sustainability characteristics, including risks and opportunities.

Consumption

- Agricultural Products
- Meat, Poultry & Dairy
- Processed Foods
- Non-Alcoholic Beverages
- Alcoholic Beverages
- Tobacco
- Household & Personal Products
- Multiline and Specialty Retailers & Distributors
- Food Retailers & Distributors
- Drug Retailers & Convenience Stores
- E-Commerce
- Apparel, Accessories & Footwear
- Building Products & Furnishings
- Appliance Manufacturing
- Toys & Sporting Goods

Financials

- Commercial Banks
- Investment Banking & Brokerage
- Asset Management & Custody Activities
- Consumer Finance
- Mortgage Finance
- Security & Commodity Exchanges
- Insurance

Health Care

- Biotechnology
- Pharmaceuticals
- Medical Equipment & Supplies
- Health Care Delivery
- Health Care Distributors
- Managed Care

Infrastructure

- Electric Utilities
- Gas Utilities
- Water Utilities
- Waste Management
- Engineering & Construction Services
- Home Builders
- Real Estate Owners, Developers & Investment Trusts
- Real Estate Services

Non-Renewable Resources

- Oil & Gas – Exploration & Production
- Oil & Gas – Midstream
- Oil & Gas – Refining & Marketing

- Oil & Gas – Services
- Coal Operations
- Iron & Steel Producers
- Metals & Mining
- Construction Materials

Renewable Resources & Alternative Energy

- Biofuels
- Solar Energy
- Wind Energy
- Fuel Cells & Industrial Batteries
- Forestry & Logging
- Pulp & Paper Products

Resource Transformation

- Chemicals
- Aerospace & Defense
- Electrical & Electronic Equipment
- Industrial Machinery & Goods
- Containers & Packaging

Services

- Education
- Professional Services
- Hotels & Lodging
- Casinos & Gaming
- Restaurants
- Leisure Facilities
- Cruise Lines
- Advertising & Marketing
- Media Production & Distribution
- Cable & Satellite

Technology & Communications

- Electronic Manufacturing Services & Original Design Manufacturing
- Software & IT Services
- Hardware
- Semiconductors
- Telecommunications
- Internet Media & Services

Transportation

- Automobiles
- Auto Parts
- Car Rental & Leasing
- Airlines
- Air Freight & Logistics
- Marine Transportation
- Rail Transportation
- Road Transportation



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