SASB Conceptual Framework

Exposure Draft

Introduction and Background

The Sustainability Accounting Standards Board™ (SASB™) is an independent, registered 501(c)3 non-profit organization engaged in the development and dissemination of industry-specific standards for disclosure and accounting of material sustainability issues. SASB is establishing an understanding of material sustainability issues facing industries and creating Sustainability Accounting Standards suitable for disclosure in standard filings of publicly-held companies to the U.S. Securities and Exchange Commission (SEC), such as the Form 10-K and 20-F. SASB addresses the unique needs of the U.S. market, establishing standards for disclosure of material non-financial impacts that are concise, comparable within an industry and relevant to the ~13,000 publicly listed companies in the United States.

The organization's mission represents a natural evolution in the history of corporate reporting. The Securities Act of 1933 and the Securities Exchange Act of 1934 led to the formation of the Securities and Exchange Commission (SEC), which Congress empowered to require and oversee corporate disclosure. This historic move, coupled with the creation of the Financial Accounting Standards Board (FASB) in 1973, led to establishing financial reporting standards and disclosure requirements aimed at protecting investors and the public.

SASB is continuing this tradition of promoting disclosure and informing investors of material information in a decision-useful format, by extending it to environmental, social and governance (ESG) factors.

SASB upholds the following general principles:

- To judiciously manage standards improvements, balancing the desire to minimize disruption of accounting, financial reporting and annual reporting with the need to improve usefulness of information. SASB balances the desire for comprehensive improvements against the need for simpler and more cost-effective incremental improvements.
- To provide clear, transparent and timely communications, endeavoring at all times to keep the public informed of important developments about SASB's operations, activities, standards setting process and timelines for public comment.
- To openly and honestly assess the "real world" application of the standards and interpret, amend or replace standards in a timely fashion if such action is warranted.

Further information about the SASB can be found on its website: www.sasb.org.

This Conceptual Framework sets out the basic concepts and definitions behind SASB's Sustainability Accounting Standards and serves as additional guidance for the adoption of the standards by corporations and the use of material sustainability data by investors.

1. Objectives of Sustainability Accounting and Disclosure

1.1 Accounting is concerned with the conceptualization of capital flows, its concrete expression in numbers, as well as budgeting, monitoring and reporting to the capital markets.[1] The Financial Accounting Standards Board (FASB) and U.S. Generally Accepted Accounting Principles (US GAAP) exist for the purpose of quantifying financial capital.

1.2 SASB's concern is with accounting for forms of capital beyond financial capital, upon which firms and their investors rely for sustained, long-term value creation. These other forms of capital include natural, human and social capitals. SASB is also concerned with accountability of companies' management of corporate governance issues associated with sustainability.

1.3 Accounting for sustainability impacts means measuring, verifying and reporting—in other words being accountable for—the environmental, social and governance performance of an organization. Sustainability accounting standards are intended as a complement to financial accounting standards, such that financial fundamentals and sustainability fundamentals can be evaluated side by side to 1) inform development of an integrated business strategy for corporate management and 2) assess ESG risks and opportunities inherent in an investment portfolio. Disclosure on SASB standards is intended to provide a complete view of a corporation's performance and positioning with respect to material issues for investors and the public.

1.4 In agreement with the SEC's position, SASB recognizes that the Form 10-K is not a substitute for regulation, nor is it a vehicle to advance social purpose. Rather, the Form 10-K is a mechanism for the delivery of information that investors need. Companies are ultimately responsible for determining information material to their operations and are required to include such information in their Form 10-K or 20-F and other periodic SEC filings. By developing key performance indicators unique to industries suitable for disclosure in the Form 10-K, SASB will help facilitate comparable corporate reporting.

Primary Users: Corporations Issuing Securities to the Public in the U.S.

1.5 SASB seeks to establish standards for disclosure and accounting of material sustainability issues by companies that issue securities to the public in the United States and are subject to U.S. Federal disclosure requirements for publicly held companies.[2]

1.6 Both national and foreign companies—to the extent that they sell securities to the public in the United States—are subject to U.S. Federal disclosure requirements. Specific disclosure requirements are highlighted in the chart below.

[1] International Accounting Standards Board (IASB) (transnational financial standards setting).
[2] Companies with more than $10 million in assets whose securities are held by more than 500 owners must register with the U.S. Securities and Exchange Commission and file annual and other periodic SEC reports.

Table 1: SEC Disclosure Requirements

SEC Disclosure Requirement	Timing of filing	Description
Form S-1	To be filed at time of registering a public company's securities with the SEC	The initial registration form for new securities required by the SEC for public companies. The S-1 contains the basic business and financial information on an issuer with respect to a specific securities offering.[3]
Form 10-K	To be filed annually	The annual report on Form 10-K provides a comprehensive overview of the company's business and financial condition and includes audited financial statements.[4]
Form 10-Q	To be filed quarterly	Form 10-Q includes unaudited financial statements and provides a continuing view of the company's financial position during the year.[5]
Form 8-K	To be filed on an ongoing, as-needed basis	Public companies must use Form 8-k to report certain material corporate events on a more current basis. Form 8-K is a "current report" companies must file with the SEC to announce major events that shareholders should know about.[6]
Form 20-F	To be filed annually	The annual report on Form 20-F must be submitted by all "foreign private issuers" that have listed equity shares on exchanges in the United States. The content of Form 20-k is similar to that of Form 10-K.

Source: SASB

1.7 SASB Standards are also applicable for public disclosure of material sustainability information by other types of corporations, including privately held corporations and foreign corporations publicly listed in other jurisdictions. However, such disclosures are not required for the protection of U.S. retail investors, and therefore the purpose and requirements associated with such disclosure are different.

Primary Beneficiary: The "Reasonable Investor"

1.8 Federal securities law seeks to protect individual investors by requiring publicly listed companies to provide annual and other periodic performance disclosure that would be necessary for a reasonable investor to make informed investment decisions (see definition of Materiality below).

1.9 Similarly, the primary beneficiary and target audience for SASB's Sustainability Standards is the "reasonable investor," understood as mainstream investors with a variety of

[3] References: http://www.investopedia.com/terms/s/sec-form-s-1.asp and http://en.wikipedia.org/wiki/Form_S-1.
[4] Reference: http://www.sec.gov/answers/form10k.htm.
[5] Reference: http://www.sec.gov/answers/form10q.htm.
[6] Reference: http://www.sec.gov/answers/form8k.htm.

investment strategies and investment horizons—from short-term to long-term—all with a goal of fructifying their investments in terms of income generation and asset valuation. This excludes:

- Short-term traders who are not beneficial owners of the firm;
- Specialty-focused investors who are investing for reasons other than economic purposes.

Institutional Investors, Fiduciary Duty and Portfolio Risks

1.10 Institutional investors in the U.S. have a fiduciary duty based on the modern prudent investor rule, which incorporates both a duty of care and a duty of loyalty. The prudent investor rule is based on modern portfolio theory and includes, among other things, a requirement to diversify investment portfolios unless it is prudent not to do so. This fiduciary duty requires institutional investors to consider ESG issues that are relevant and material, especially at the portfolio level.[7]

1.11 However, rules for disclosure traditionally apply to companies or "issuers" rather than an industry, and therefore do not address systemic risk to a modern, diversified investment portfolio. The complex nature of ESG risk and the prevalence of environmental and social externalities means that portfolio risk goes unaddressed in single issuer disclosure requirements.

1.12 SASB is addressing portfolio risk by seeking public disclosure on sustainability performance and externalities at the sector and industry levels. Identification of sustainability issues at the industry and sector levels enables the analysis of sustainability risks and opportunities across diversified investment portfolios (portfolio risk) of large investors (universal owners) who are invested in a cross section of the economy.[8]

Other Beneficiaries

1.13 While SASB's goal of broadening the definition of materiality to include non-financial ESG information can be very beneficial to those concerned with the contribution of business to sustainable development, it is primarily for the benefit of those concerned with the financial performance of their investments.

[7] References: http://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf; http://www.unepfi.org/fileadmin/documents/fiduciaryII.pdf.

[8] Universal ownership" is a term coined by Bob Monks and Nell Minow in *Corporate Governance* in 1995 to describe an institutional investor owning such a wide range of asset classes distributed among economic sectors that the organization effectively owns a slice of the broad economy. ("Universal Ownership: Exploring Opportunities and Challenges", Saint Mary's College of California, Center for the Study of Fiduciary Capitalism, April 2006).

1.14 Consistent public disclosure of performance on material sustainability issues by all companies within an industry and sector will enable policy makers and large investors to better understand systemic effects of corporate activities, and how externalities from one industry can impact other industries and public well-being.

1.15 Disclosure of material issues is important to companies, regulators and the public because social and environmental impacts of corporate operations can present material costs to investors and society.

How Investors Use ESG Data in Financial Analysis

1.16 In the United States, investors representing more than $3.07 trillion (out of $25.2 trillion) of assets under management (AUM) indicate that they factor ESG information into investment decisions.[9] Mainstream investors represent one-third of the participants in SASB's Industry Working Groups.

1.17 A recent report[10] by the United Nations Principles for Responsible Investment (UNPRI), found that investors use ESG information in the following ways:

- **Macro – economic analyses**: To understand industry trends and externalities likely to affect the economic outlook and therefore value creation and capital formation.
- **Industry level analysis:** To understand factors driving competitiveness and the potential for sustained value creation in an industry, as well as externalities from an industry likely to affect other industries (and therefore portfolio risks).
- **Company analysis:** To understand management quality and corporate strategy.
- **Valuation:** To adjust traditional valuation parameters and assumptions, including cash flow and weighted average cost of capital (WACC), to reflect performance on key material issues.

1.18 Based on separate research conducted by UNPRI and SASB, a lack of comparable data and/or a lack of understanding the materiality of the issue to the industry and/or company have made it challenging for investors to effectively use ESG information. Currently, obtaining ESG data that is of sufficient quality and is decision-useful can require a substantial amount of time and expense.

1.19 SASB's mission is to ensure that investors have access to the material sustainability information that is necessary to make informed investment decisions, with reasonable effort and

[9] US SIF: The Forum for Responsible and Sustainable Investment, 2013.
[10] "How Investors are Addressing Environmental, Social and Governance Factors in Fundamental Equity Valuation," United Nations Principles for Responsible Investment (UNPRI), February 2013. Online: http://www.unpri.org/viewer/?file=wp-content/uploads/Integrated_Analysis_2013.pdf

minimal expense. Hence SASB's focus on making material sustainability information available in the Form 10-K and other SEC filings.

1.20 SASB Standards and other products supports investors in their efforts to assess ESG factors in traditional equities analysis through the following means:

- **Identifying risks and opportunities:** SASB's Sustainable Industry Classification System (SICS) groups industries with similar sustainability impacts. The organization's Materiality Map prioritizes the materiality of issues within and across industries. Together, SICS and the Materiality Map enable investors to see under- or over-exposure to certain types of ESG risks and opportunities depending on their sector allocation, and adjust their exposure accordingly.

- **Comparison and benchmarking:** The data that will result from 13,000 publicly traded companies reporting with SASB accounting metrics will enable investors to perform peer-to-peer comparisons on critical dimensions of ESG performance and establish industry benchmarks for material ESG factors against which issuers can be compared. The availability of financial fundamentals alongside sustainability fundamentals provides the data needed to adjust valuations for certain assumptions, evaluate management quality and select stocks.

2. Key Definitions and Approach

Sustainability

2.1 In the context of SASB Standards, sustainability refers to environmental, social and governance factors that have the potential to affect corporations' long-term value creation and are in the interest of investors and the public. Sustainability impacts arise because of the way companies use resources and impact environment and society through manufacture and/or delivery of their products or services. As such, these impacts are closely associated with business models and operations and must be evaluated on an industry basis in order to maintain materiality. Sustainability factors include the management of corporations' environmental and social impacts, the systems that govern and guide policies and actions, and the underlying environmental and social capital upon which value creation can be sustained. Investors and the public deserve to be informed about these impacts, which may ultimately impact financial capital formation and economic value creation.

2.2 SASB evaluates materiality of sustainability issues by looking beyond conventional measures of assets and liabilities to those embedded in aspects of social and environmental performance and stakeholder relationships. The universe of issues SASB evaluates for materiality within an industry is shown in Table 3.

Accounting for Non-financial Capital

2.3 As noted earlier, IASB describes conventional or “financial” accounting as *“… the conceptualization of capital flows, its concrete expression in numbers, as well as budgeting, monitoring and reporting to the capital markets.”*

2.4 Unlike financial accounting, non-financial accounting does not aggregate into clear flows. Although environmental and social capital can be conceptually understood and accounted in terms of assets and liabilities, SASB’s approach to sustainability accounting consists of determining standard disclosure and metrics to account for companies’ performance on material sustainability issues.

2.5 The impact of business on society and the environment, as well as the impact of sustainability issues on business, is generally unique to specific sectors and industries (this will be discussed in more detail in Section 3). Therefore, sustainability accounting standards must be developed as independent sets that are created using a uniform method, but are uniquely tailored to each industry. Using universal metrics (comparable and additive across all industries and sectors) can achieve the same level of complete accounting as with financials; however, doing so will lead to disclosure on issues that are not material to all industries and add to the disclosure burden of companies.

2.6 Lastly, in terms of actual performance on sustainability accounting, SASB will default to the minimum information that provides decision-useful information (i.e. it presents a relative view of performance by which peers can be compared), rather than a complete accounting that may be necessary for policy- or target-setting.

2.7 SASB is concerned with differentiating performance between issuers and industries, not with providing a scientifically accurate and complete accounting for regulatory purposes.

Relationship to US GAAP and Fair Value Accounting (FVA)

2.8 FASB and US GAAP exist for the purpose of quantifying financial capital. SASB’s concern is with accounting for forms of capital beyond financial capital: environmental and social. These other forms of capital are not accurately or adequately “priced,” either historically or marked to market, as in fair value financial accounting treatments.

2.9 Because robust markets do not yet exist for many of these critical non-financial capitals, and many are underpriced or not priced at their true cost, SASB will seek to define parameters that express a true and fair representation of actual performance, for consideration by investors and analysts. Such areas include:

- Attention to management of critical capitals;
- Vulnerability to depletion or misuse of these capitals;
- Scenario-planning regarding alternative resources;
- Risks associated with mismanagement of certain environmental or social issues;
- Opportunities attendant with addressing global or industry sustainability challenges.

2.10 SASB believes accounting for sustainability performance will allow markets to better “price” or adequately consider these other forms of capital and their effect on financial valuation.

3. Method for Determining Materiality of Sustainability Issues

The Legal Definition of Material Sustainability Issues

3.1 Materiality is a fundamental principle of financial reporting in the United States. Generally, the concept of materiality recognizes that some matters, either individually or in the aggregate, are important to the fair presentation of an entity's financial condition and operational performance.

3.2 U.S. Federal law requires publicly listed companies to disclose material information, defined by the U.S. Supreme Court as "presenting 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." (TSC Indus. V. Northway, Inc., 426 U.S. 438 (1976))

3.3 Specific disclosure requirements (see Table 1) are established by federal regulation (Regulation S-K) and require publicly listed companies to disclose material information at the time of initial public offering (Form S-1), and thereafter on an annual and quarterly basis (Form 10-K and 10-Q) and on an ongoing basis upon material corporate events (Form 8-K). Similar disclosure requirements are imposed on foreign corporations that issue shares to the public in the U.S. (mainly Form 20-F).

3.4 When sustainability information is material to a company, it typically materializes in two forms: 1) Known trends, demands and uncertainty that have a material impact on financial results; 2) Further Information that is relevant to the "reasonable investor" in the total mix of information.

Known Trends, Demands and Uncertainty – the MD&A Section of Form 10-K

3.5 In Basic Inc. v. Levinson[11], the Supreme Court provided an interpretation of the concept of materiality in the context of contingent or speculative events, stating that: (1) contingent or speculative events are not immaterial for the mere fact of their being contingent or speculative in nature; (2) the materiality of a contingent or speculative event depends on the significance a reasonable investor would place on the withheld or misrepresented information; and (3) the significance of contingent or speculative events in the investment context turns on both the probability of its occurring and the magnitude of the impact if it does eventually occur.

3.6 Regulation S-K sets the specific disclosure requirements associated with Form 10-K and other SEC filings, and Item 303 of the regulation pertains to the content of the Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) section of Form 10-K. At its root, Item 303 requires that an SEC registrant discuss its "financial condition" and "results of operations." This includes some specific disclosures, but also includes more broadly, "such other information that the registrant believes to be necessary to an understanding of its financial condition, changes in financial condition and results of operations."[12]

[11] *Basic Inc. v. Levinson, 485 U.S. 224 (1988)*
[12] Reference: http://www.ecfr.gov/cgi-bin/text-idx?c=ecfr&rgn=div5&view=text&node=17:2.0.1.1.11&idno=17#17:2.0.1.1.11.4.35.3

3.7 Item 303 requires that companies describe in their MD&A, known trends, demands and uncertainty that have a material impact on financial results.

Specifically, it requires description of:

"Any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations. If the registrant knows of events that will cause a material change in the relationship between costs and revenues (such as known future increases in costs of labor or materials or price increases or inventory adjustments), the change in the relationship shall be disclosed."[13]

3.8 In 1989, the Securities and Exchange Commission identified two assessments management must make where a trend, demand, commitment, event or uncertainty is known[14]:

(1) Is the known trend, demand, commitment, event or uncertainty likely to come to fruition? If management determines that it is not reasonably likely to occur, no disclosure is required.

(2) If management cannot make that determination, it must evaluate objectively the consequences of the known trend, demand, commitment, event or uncertainty, on the assumption that it will come to fruition. Disclosure is then required unless management determines that a material effect on the registrant's financial condition or results of operations is not reasonably likely to occur.

In other words, in determining whether a trend, demand, commitment, event or uncertainty should be disclosed, management should base its decision on probability and magnitude:

- 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.

3.9 The SEC states that “reasonably likely” means a degree of likelihood that is more than a “mere possibility” but less than “more likely than not.” Non-SEC interpretive guidance generally agrees that “more likely than not” is a subjective way to say “greater than 50% likelihood.”[15] This threshold is bound on the other side by a threshold of “more than remote.” The Federal Accounting Standards Advisory Board, among others, defines the highest likelihood as “probable.”

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[13] Reference: Regulation S-K, 17 CFR 229.303(a)(3)(Item 303)

[14] Reference: Securities Act Release No. 6835 (May 18, 1989), Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures, 54 FR 22427, 22430.]

[15] Reference: http://www.pwc.com/en_us/us/tax-compliance-services/assets/fin_48_tax_penalty_standard.pdf

Other Sustainability Information Relevant in the Total Mix of Information

3.10 Beyond the specific disclosure requirement of Regulation S-K, Securities Act Rule 408 and Exchange Act Rule 12b-20 requires a registrant to disclose, in addition to the information expressly required by SEC regulation, "such further material information, if any, as may be necessary to make the required statements, in light of the circumstances under which they are made, not misleading." Therefore, companies should consider if material sustainability information is relevant for inclusion in other sections of Form 10-K, including the following sections.

Description of Business

3.11 Item 101 of Regulation S-K requires description of business of companies and their subsidiaries. Specifically Item 101(c)(1)(xii) expressly requires disclosure regarding certain costs of complying with environmental laws:

> *"Appropriate disclosure also shall be made as to the material effects that compliance with Federal, State and local provisions which have been enacted or adopted regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, may have upon the capital expenditures, earnings and competitive position of the registrant and its subsidiaries."*

Legal Proceedings

3.12 Item 103 of Regulation S-K requires companies to briefly describe any material pending or contemplated legal proceedings. Instructions to Item 103 provide specific disclosure requirements for administrative or judicial proceeding arising from laws and regulation targeting discharge of materials into the environment or primary for the purpose of protecting the environment.

Risk Factors

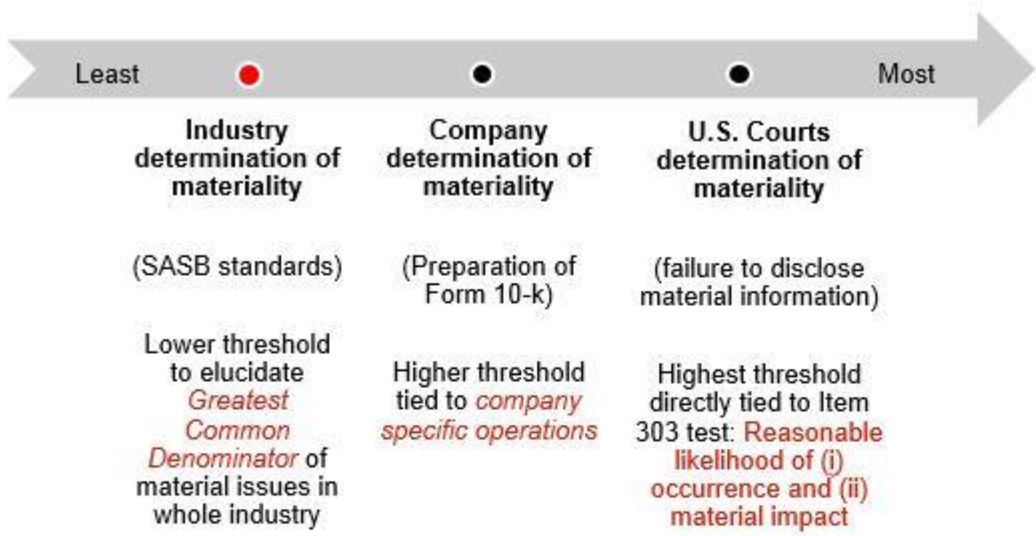
3.13 Item 503(c) of Regulation S-K requires filing companies to provide a discussion of the most significant factors that make an investment in the registrant speculative or risky, clearly stating the risk and specifying how a particular risk affects the particular filling company.

Evidentiary Requirements for Materiality at the Industry Level

3.14 SASB's materiality assessment is similar in nature to that applied by companies (in the preparation of their Form 10-K or U.S. courts (in assessing claims of failure to disclose material information). However, companies, and possibly U.S. courts, make the ultimate determination of materiality.

3.15 SASB's materiality assessment has a lower evidentiary requirement as it is done at the industry level and is used as a guide for determining industry issues that are likely to be material to most, if not all, companies within the industry.

Table 2: Evidentiary Requirement of Materiality Determination



Source: SASB

3.16 This approach is consistent with FASB's approach to entity-specific materiality determination. In its Concept Statement, FASB states that:

> *"Information is material if omitting it or misstating it could influence decisions that users make on the basis of the financial information of a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude or both of the items to which the information relates in the context of an individual entity's financial report. Consequently, the Board cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation."*[16]

Industry Focus and Cross-Cutting Issues

Industry-level Approach and SICS

3.17 SASB is developing sustainability accounting standards at the industry level, focusing on intractable issues that are closely tied to resource use and business models, and other factors at play in the industry that can result in unsustainable outcomes.

[16] FASB, September 2010 Concepts Statement, "Chapter 3: Qualitative Characteristics of Useful Financial Information".

3.18 These issues are material at an industry level because companies that provide similar products and services tend to have similar business models and use resources in the same way, and as a result have similar impacts on society and the environment.

3.19 Most major industry classification systems use revenue as their basis for classifying companies into specific sectors and industries. However, a company's market value is determined by much more than its financial performance. In many industries it is estimated that as much as 80 percent of market capitalization is made up of intangibles, such as human capital, intellectual property and brand.

3.20 To address this shortcoming, SASB developed the Sustainable Industry Classification System (SICS), which categorizes industries in order to acknowledge their resource intensity as well as their sustainability innovation potential. The system is tied back to standard classification systems (e.g., SIC, GICS and BICS) for users' ease. Companies themselves have not been reclassified, rather the sustainable industry taxonomy is an overlay on the traditional classification systems. A company can determine the relevant SICS industry from its ticker on the SASB website.

3.21 SASB's main work is establishing and maintaining industry-specific sustainability accounting standards appropriate for use in standard filing instruments, such as the Form 10-K and 20-F. Standards are being developed for each of the 80+ industries populating SICS's lowest level.

3.22 The system then classifies the industries at a middle level, or industry groups, based on sustainability impact similarities. The industry groups serve an operational purpose, as SASB runs industry working groups (IWG) comprised of experts from the relevant industries for the development of the sustainability accounting standards.

3.23 At the highest level, the industry working groups and their industries are grouped into 10 thematic sectors, which are primarily a reflection of the type of resources used or a reflection of the ultimate purpose given to these resources.

3.24 SASB's Materiality Map is the starting point for understanding the relative materiality of issues in each of the 80+ industries included in SICS' lowest level and for developing sustainability accounting standards. SASB's approach to identifying material issues is explained in further detail in this document.

SASB Approach to Cross-cutting Issues

3.25 Certain prominent sustainability issues such as climate change, water, human capital and political contribution are the focus of activists, government agencies, or investors who need to understand the aggregate effect of business on a specific issue, in order to determine activist actions, government programs, investment strategy or portfolio allocation. These proxy voting groups seek corporate disclosure on cross-cutting issues in most, if not all, industries, in order to compare performance across all industries and to analyze an issue comprehensively, looking at either risks across investment portfolios or cumulative impact of business on society.

3.26 However, while this approach may provide comparable data, it can lead to disclosure on immaterial issues and add to the disclosure burden of companies without sufficient benefit.

3.27 As a response, SASB proposes a careful approach to cross-cutting issues, balancing the broad investor and societal interest for a specific issue and its mission to help companies determine issues that are material in their specific industry.

3.28 SASB will not, as a matter of principle, include certain ESG issues in the disclosure standard for every industry. Instead, SASB will systematically assess the materiality of these issues to a particular industry, understanding the specificity of how these issues impact, or are impacted, by business in different industries.

3.29 Only certain key industries are truly relevant for cross-cutting issues and the business impact and appropriate measurement of cross-cutting issues differ vastly from industry to industry, challenging the need for disclosure on similar issues and accounting metrics across industries (e.g. climate change).

3.30 In addition, requiring universal disclosure on cross-cutting issues poses the risk of requiring immaterial information and undermines SASB's efforts to streamline ESG disclosure by focusing on issues that drive value creation. If disclosures raise reporting costs without addressing a material issue, it is unlikely to achieve approval and widespread adoption. As recent legal precedent has shown, the SEC must put a renewed focus on cost-benefit analysis as a key litmus test for expanded disclosure requirements.

3.31 Lastly, Item 303 of Regulation S-K, which governs the management discussion and analysis (MD&A) section of the Form-10K, cites magnitude, probability and timing of issues as important variables when considering disclosure. Ultimately, SASB will ensure that any cross-cutting issue included in the standard meets these SEC criteria for inclusion in the Form 10-K.

3.32 In doing so, SASB makes a systematic analysis of key cross-cutting issues and how they specifically affect each industry. SASB approaches its research process with respect to the following cross-cutting issues:

- Natural Capital (climate change, water)
- Social Capital (extensive license to operate, externalities)
- Human Capital (talent, labor relations, safety)
- Innovation & ESG Products and Services
- Leadership and Governance (including supply chain)

3.33 SASB follows a rigorous process to assess the specific impact of cross-cutting issues for each of the industries, including:

- Defining channels of impact of cross-cutting issues on companies' economic or financial performance (e.g., likelihood of pricing of GHG emissions or costs associated with adaptation)

- Defining characteristics of industries affected by the issue (e.g., large direct emitters for GHG emissions or operations easily disrupted by weather event for adaptation)
- Determining whether and how cross-cutting issues materially impact companies in a particular industry (e.g., GHG emissions (SF6) for the semiconductors industry; adaptation for the telecommunications industry; carbon-intensive investments for financials industries)

Accounting for Other Forms of Capital and Externalities–A Concept of Holistic Performance and Value Creation

3.34 SASB standards are designed to enable the more holistic measurement of corporate performance and value creation. Whereas traditional measures of corporate performance focus on operational or financial results, a more holistic concept of value creation accounts for value created and costs generated across all forms of capitals—not only financial and manufactured, but also social, intellectual, human and natural, some of which are not necessarily in the direct control of corporations.

3.35 This holistic approach to value creation expands the scope of measures of net value creation, which typically is a ratio of operational and financial performance over the use of financial or manufactured capital (e.g., return on investment or assets).

3.36 Disclosure of the use of various forms of capitals and externalities should allow investors to assess financial results in the context of other—non-financial—dimensions of corporate performance (e.g., ratio of financial returns and environmental capital use or externalities). In turn, this will allow them to assess the extent to which companies' profits are dependent upon capital they do not own or control (for example human capital and natural capital) or externalities (environmental or social), understanding that specific strategic considerations are necessary for the management of capitals that are not owned or controlled by companies or that over time, politics and markets will find a way to price externalities.

3.37 This is consistent with the concept of Integrated Reporting as advanced by the International Integrated Reporting Council (IIRC) in its Draft Prototype Framework. According to the Draft Framework:

> *"Integrated Reporting should take account of the extent to which costs or other effects on various capitals have been externalized, i.e., the costs or other effects have impacted capitals that are not owned by the organization, such as the environment, employees, the local community and future generations. Externalities may be positive or negative, i.e., they may result in a net increase or decrease to the value embodied in capitals. Externalities may ultimately increase or decrease investor value in the longer term, and without appropriate disclosure of their effects, long-term investors will not have the information they require to make decisions about long-term value and be able to allocate resources accordingly."*

3.38 To enable a holistic assessment of value creation, SASB creates accounting standards for different forms of capitals and externalities that are not accounted for in a systematic way in in annual disclosures of publicly listed companies in the United States. These capitals and externalities are addressed in three broad dimensions – environmental, social and governance.

- The **environmental dimension** includes natural capital or natures' input to the factors of production, such as water, ecosystems and biodiversity. It also includes environmental externalities caused by corporations, such as GHG emissions or other types of release.
- The **social dimension** includes human capital, which encompasses management of employees' talent, skills and experience, as well as the management of employees' labor rights and health and safety. It also addresses the management of social issues that results from a company's social license to operate.
- The **governance** 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 interest of broader stakeholder groups (government, community, customers, employees, environment), and therefore create a potential liability or worse a limitation or removal of license to operate.

SASB's Approach to Governance

3.39 SASB's approach to governance differs from the traditional concept of corporate governance in that: 1) it expands the scope of stakeholders whose interests are taken into account and 2) it focuses on corporate governance issues rather than the corporate structures and processes in place to address corporate governance issues.

3.40 SASB places particular emphasis on the shareowners as one of the main groups that are interested in governance issues as an indication of management quality. This has a number of implications:

- Focusing on actual shareowners, rather than potential investors;
- Re-balancing the artificial leverage of short-term investors with that of longer-term investors, therefore identifying true characteristics of share ownership;
- Protecting the interests of long-term shareowners, giving mandate/fiduciary duty to consider long-term environmental and social issues.

SASB's Relationship to ESG Issues of SEC Concern

3.41 The SEC has taken up a number of sustainability issues independently, leading to new guidance on issues including climate change, regulation on conflict minerals and payments to foreign governments by U.S. oil and mining companies.

3.42 There are also ESG issues currently under SEC consideration. For example, the SEC is expected to be considering a petition to require publicly traded corporations to disclose to shareholders all of their political donations.

3.43 Whenever an issue is under consideration by the SEC, SASB will not duplicate SEC efforts. This is because SEC review will either result in dismissal of the issue or a line item mandate for disclosure, in which case the guidance to companies is clear. SASB's efforts are best placed by focusing on the myriad of issues for which there is no clear guidance to companies regarding the materiality of the issue or basis for disclosure.

The Source of Materiality of Industry-specific Sustainability Issues

3.44 The nature and impact of sustainability issues on specific sectors and industries are driven by the sustainability profile of these sectors and industries, driven by three main factors:

- Extensive license to operate
- Use of common capitals
- High costs on society and/or environmental externalities

Industries with Extensive License to Operate

3.45 Material sustainability issues arise in industries that benefit from an extensive license to operate. These licenses are often the result of:

- **Public-private partnerships**: Industries benefit from an extensive license to operate where a public-like service is delegated to the private sector, with captive demand and monopolistic tendencies. This includes privatization of public utilities (water, electricity), private operation of healthcare delivery and de-mutualization of stock exchanges.
- **Use of public goods:** Strong license to operate can also result from an exclusive license to use public goods, such as the right to install cables in the ground, use the wireless spectrum for telecom and cable companies, or to drill and extract non-renewable resources for the oil and gas and extractive industries.
- **Intangible benefits:** Extensive license to operate can also result from more intangible benefits that society grants to the private sector. For example, the software, social media and telecom industries benefit from a strong license to operate because their business models create strong network effects and natural monopolies. Pharmaceutical and biotech companies benefit from strong intellectual protection in exchange for innovation that can enhance public health. The insurance and asset management industries benefit from quasi-mandatory schemes for insurance (e.g. auto insurance) and retirement services (tax deductibility of 401-k).

3.46 When society grants a strong license to operate, there is an expectation that the industry will deliver, in return, a benefit to society. Therefore, companies in industries that benefit from a strong license to operate have expectations of performance and contribution beyond their investors' financial return on investment, and more broadly to provide a social return on investment. For the biotech and pharmaceutical industries, this translates into a balance of society's interest between (a) IP protection to ensure that sufficient investment goes into R&D for new treatment, and (b) providing incentives (or regulations) to alleviate the side effects of IP-based exclusivity and provide medicine and treatment to all who need it.

3.47 Pharmaceutical and biotech companies, for example, benefit from strong intellectual protection in exchange for innovation that can enhance public health. The largest Health Care

Delivery organizations are non-for-profit entities affiliated with major universities or religious organizations, calling to question (by some) the existence of private, for profit hospitals.

3.48 Serving society's interest, or managing social issues that are inherent to a business model, therefore becomes a key value driver for companies that benefit from a strong license to operate. Significant economic and financial impact—and therefore materiality—results from the likelihood that companies will have to undertake new activities or lines of business to justify their extensive license to operate (through actual or looming regulation or government monitoring), their ability to make socially impactful activities profitable and the cost of regulation for those who fail to address social issues.

Use of Common Capitals

3.49 Material sustainability issues arise in industries that rely on common capitals as a source of value creation, beyond financial, manufactured or intellectual capital. Common capitals are those that are available to companies as a source of value creation but that are not owned or controlled by those companies.

3.50 Common capitals, as defined by the IIRC, include natural capital [nature's input to the factor of production (e.g. ecosystems, biodiversity, etc.)] and human capital (e.g. employees' skills and experience and their motivations to innovate).

3.51 Industries that make substantial use of common capitals are dependent on the availability and quality of those capitals for their long-term performance, even from a purely financial perspective.

High Costs on Society and Environmental Externalities

3.52 Material sustainability issues arise in industries that create high external sustainability impacts, either through imposing high costs on society or creating large environmental externalities.

3.53 For example, industries can have a high external impact on society when they rely heavily on outsourcing, imposing a significant social cost on both the home and host country. Other examples of industries with high cost on society are those with a high incidence of corrupt practices.

3.54 Large environmental externalities include industries with either a large environmental footprint, high level of pollution or GHG emission; or industries that are subject to externalities created by other industries, such as climate change. This is related to but different from the concept of natural capital, which relates to nature's input to the factors of production.

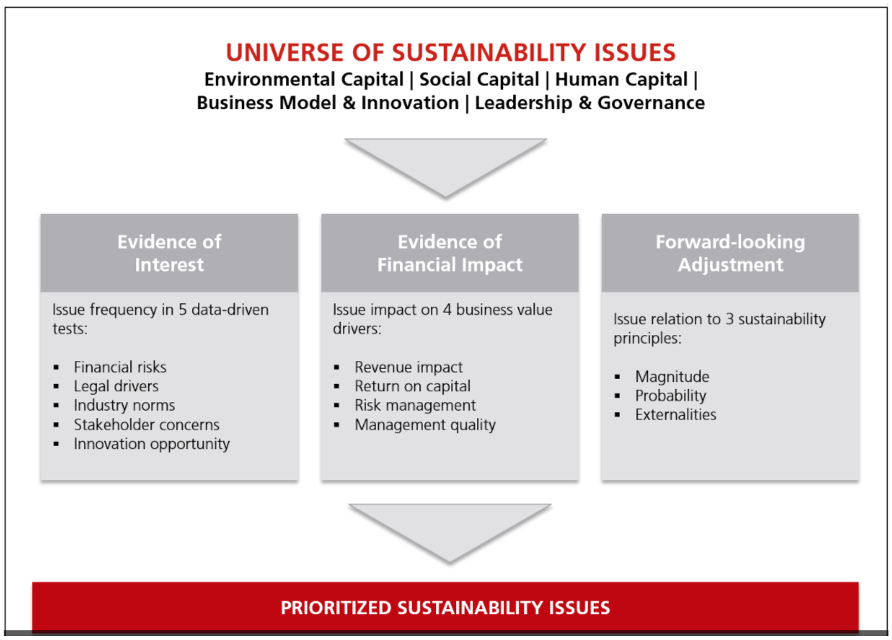
3.55 Environmental and social externalities, by definition, do not currently affect the financial returns of companies. However, over time, large externalities will likely become internalized, either through social and political pressure or through market mechanisms, making these companies and industries less profitable and competitive.

3.56 For example, as public perception of climate change continues to evolve, the environmental cost of emissions is likely to be internalized though regulatory or voluntary schemes to put a price on carbon. Similarly, social externalities associated with offshoring are likely to cancel its cost benefit and force companies to find new markets or bring production back on-shore. Companies that rely on corrupt practices are likely to become target of public outcry and lose their license to operate once transparency is reinstated.

Importance and Types of Evidence of Materiality

3.57 The determination of material issues at the industry-level is based on a comprehensive assessment of evidence of materiality using a three-prong approach—evidence of interest, evidence of financial impact and forward looking adjustment.

Table 3: Universe of Sustainability Issues and SASB's Approach to Determining Material Issues



Evidence of Interest

3.58 SASB assesses the materiality of sustainability issues by looking at evidence of interest from the perspective of a hypothetical "reasonable" investor, consistent with the Supreme Court definition of material information as "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 the information made available." *(TSC Industries v. Northway, Inc., Supreme Court, 1976)*

3.59 Evidence of interest is assessed with three broad categories of stakeholders, both through a systematic review of publicly available filings and other documents, and through a comprehensive direct survey of representatives from the three interest groups:

- **Investor Interest.** Evidence of interest is assessed directly both through a systematic review of issues raised in shareholder resolutions and through a survey of investors about the materiality of pre-selected sustainability issues during the SASB industry working group (IWG).
- **Company determination of materiality.** Evidence of interest is assessed both though a systematic review of issues disclosed by companies in the relevant industries in their Form 10-K and through a survey of a subgroup of those same companies during the SASB IWG process. Company disclosure in the Form 10-K is considered a proxy for what is considered material and of interest to mainstream investors.
- **Interest from a broader range of stakeholders.** Evidence of interest is assessed through a systematic review of sustainability issues raised by a broader range of stakeholders, both through a systematic review of sustainability reports and legal and other news stories and through a survey of non-market participants during the SASB IWG Process.

Evidence of Financial Impact

3.60 SASB also assesses materiality of sustainability issues by looking at evidence of financial impact. U.S. securities regulation (Regulation S-K) requires publicly listed companies to disclose in their Form 10-K [under the Management's Discussion and Analysis (MD&A) section] information that "will enhance a reader's understanding of its financial condition, changes in financial condition and results of operations."

3.61 As described earlier, companies must disclose of "**known trends or uncertainties** that have had or that the registrant **reasonably expects** will have a **material** favorable or unfavorable **impact on net sales or revenues or income** from continuing operations." *(17 CFR 229.303 - (Item 303 (a) (1) and (3))*

3.62 Financial impact of sustainability issues results from society, regulators, consumers and long-term investors' increasing pressure on individual companies to reduce their negative impact on the environment, society and local communities.

3.63 In addition, some of these stakeholders have higher expectations of the social and environmental responsibilities of companies and industries that benefit from an extensive license to operate, through the operation of quasi-public service or natural monopolies, privileged use of public goods, strong intellectual property or fiduciary duty.

3.64 SASB conducts extensive research to identify evidence of financial impact associated with material sustainability issues, identifying specific channels of impacts, mainly profits (revenues and costs), assets and liabilities, and cost of capital.

3.65 For example, market share or pricing power can be impacted by performance of competing products and services on relevant sustainability issues. Costs can be impacted by operational efficiency (energy, labor), sustainability-related regulation or through impact of sustainability issues on the availability or price of raw material or other input for production. Both tangible and tangible assets can be materially impacted by sustainability factors, as well as liabilities.

3.66 Lastly, financial condition can be impacted by sustainability factors through access and cost of capital, reflecting emerging sustainability risks and allocation of capital towards more sustainable industries.

3.67 Financial impact of sustainability issues can be either actual or potential; acute or chronic; and positive or negative. Actual impacts, for example, might materialize in the form of existing regulation and known changes in consumer demand. Acute impacts result from an event, such as an oil spill or mine collapse, whereas chronic impacts are due to long-term chronic erosion of value from ignoring or mismanaging an issue, such as climate change or resource scarcity. Potential impacts, on the other hand, are latent due to pending regulation on sustainability topics, threats of competition from products or services that embed sustainability factors, or increased investor interest in non-financial performance.

Forward-looking Adjustment

3.68 Certain forward-looking sustainability issues, by essence, are not yet on the radar screen of "reasonable" investors, or do not yet materially impact the financial condition of a company. For example, certain environmental factors are externalities that are expected to become internalized though regulation, while others materialize as high-impact, low-probability events.

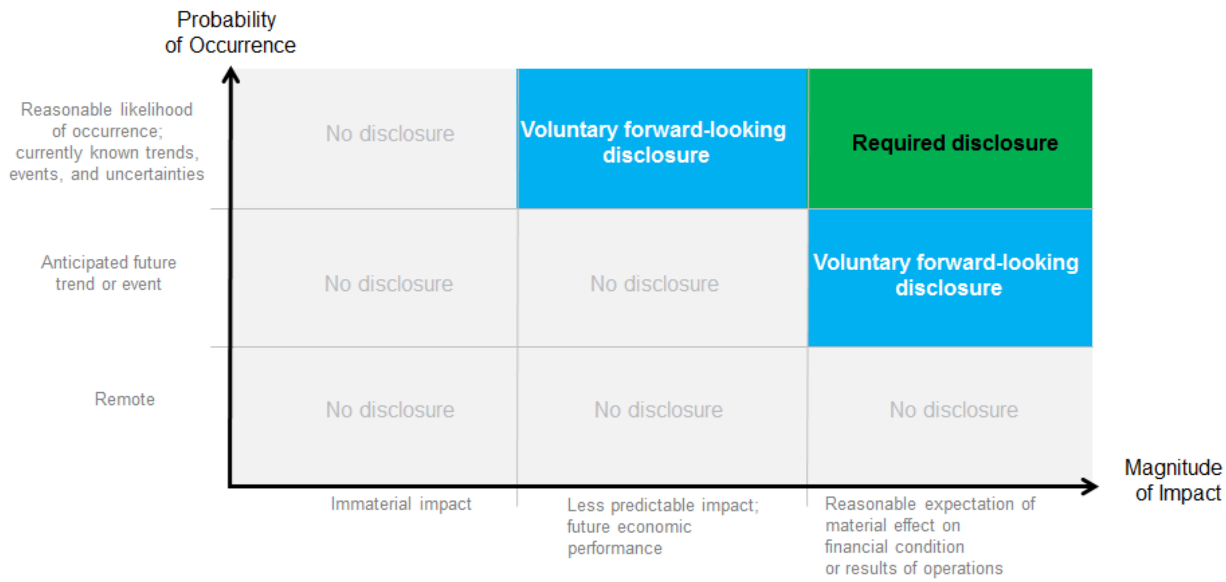
3.69 Other environmental factors are forward looking because the impact of industry practices on the environment is not yet fully understood and more scientific research is necessary before the full, potential material effect can be assessed.

3.70 Following specific criteria, the SEC mandates disclosure of certain forward-looking information in a company's Form 10-K under the MD&A section, as detailed earlier. Also previously described are the three principles regarding materiality of forward-looking information as outlined by the U.S. Supreme Court in *Basic Inc. v. Levinson.*

3.71 In accordance with Securities laws, SASB assesses the materiality of forward-looking sustainability issues by applying a two-part test based on the Supreme Court's ruling in *Basic v. Levinson* (see Figure below).

3.72 The first test looks at the probability of occurrence—whether a sustainability issue is reasonably likely to affect a company. The second focuses on the magnitude of impact—whether the effect of a sustainability issue is reasonably likely to have a material effect on the company's financial condition or results of operations.

Figure 1: Materiality Assessment for Forward-looking Issues



Source: SASB

3.73 SASB looks at these two dimensions when determining materiality of forward-looking sustainability issues. Known trends, events and uncertainties related to a sustainability issue that are "reasonably likely" to occur and whose impact is reasonably likely to materially affect the company's financial condition (green quadrant) are material and require disclosure.

3.74 However, a "reasonably likely" event with less predictable impact, or a high magnitude impact with a more remote likelihood of occurrence (blue quadrants) would not be material and disclosure would be voluntary, subject to Safe Harbor rules.

3.75 SASB's evidence-gathering approach results in a comprehensive, data-driven matrix, or Evidence Table, that reflects all sources of evidence for the three pillars of our approach– Evidence of Interest, Evidence of Financial Impact and Forward Looking Adjustment.

3.76 These three lenses of SASB's approach to materiality provide a robust, evidence-based, multi-stakeholder and rigorous understanding of the key material sustainability issues for each industry.

4. Characteristics of Sustainability Accounting and Disclosure

Principles

4.1 SASB's standards development process facilitates broad participation and objectively considers all stakeholder views. This process is subject to oversight from an external Standards Council and the SASB Board of Directors. SASB's principles guide all internal and external stakeholders who are involved in setting industry standards.

4.2 All standards issued by SASB must meet the following minimum set of criteria:

- **Relevant:** Adequately describes performance related to the material issue, or is a proxy for performance;
- **Useful:** Provides decision-useful information to companies and investors;
- **Applicable:** The metric is applicable to most companies in the industry;
- **Cost-effective:** The data are already collected by most companies or can be collected in a timely manner and at a reasonable cost;
- **Comparable:** The data allow for peer-to-peer benchmarking within the industry;
- **Complete:** Individually, or as a set, the indicator provides enough information to understand and interpret performance associated with the material issue;
- **Directional:** The metric provides clarity about whether an increase/decrease in the numerical value signals improved/worsened performance;
- **Auditable:** The data underlying this metric can be verified by auditors.

4.3 SASB uses the following set of principles to guide its decision-making process in developing standards and to serve as a checklist when tracking its progress. SASB will issue standards that are:

- **Applicable to all investors.** SASB publishes standards on an issue *if and only if* the evidence base indicates that the issue is material to investors of all types.
- **Pertinent and relevant across an industry.** SASB only publishes standards on issues that present a robust evidence base for being systemic and/or endemic to the industry.
- **Focused on driving value creation.** In addition to using an evidence-base to determine materiality, SASB strives to ascertain, through research and debate within the industry working groups, the link of each issue with long-term value creation, valuation and/or risk mitigation**.**
- **Expected to bring benefits that exceed the perceived costs.** SASB strives to determine that a proposed standard fills a significant need on the part of investors and that the perceived costs it imposes, compared with possible alternatives, are justified in relation to the overall expected benefits.
- **Actionable by the companies.** The standards are within the control or influence of companies and industries.
- **Easily verified.** The standards are measurable, quantifiable when possible, comparable, replicable and auditable.
- **Objective and support decision-making**. SASB ensures, insofar as possible, the neutrality of information resulting from its standards. To be neutral, information must report non-financial performance as faithfully as possible, emphasizing material issues

rather than value judgments.

- **Highest in quality at any given time**. SASB strives to integrate best-in-class thinking and data availability to identify the most appropriate approaches. Standards utilize a consistently applied framework, clear and unambiguous language, and the detail necessary to support replicable disclosure from company to company.
- **Reflective of the views of stakeholders.** SASB actively solicits input and carefully weighs all stakeholder views in developing standards. When needed, SASB acts as the final determinant of standards and bases such determination on research, industry consultation, public input, SASB's judgment and careful deliberation about the usefulness, materiality and cohesiveness of resulting information.
- **Determined to support the shift to integrated reporting**, that is to say, the inclusion of sustainability standards in financial disclosures, such as the Form 10-K and 20-F. The standards are designed to be compatible with financial disclosure mechanisms currently required by the SEC.
- **Determined to support the convergence to international accounting standards**, by considering the usefulness of the standards to companies with global operations, international companies with significant activity in the U.S. and compatibility with existing efforts in disclosure and reporting frameworks in countries around the world.

Decision-useful

4.4 SASB believes comprehensive, industry-specific sustainability accounting standards developed through a rigorous, evidence-based process will provide investors and companies with decision-useful, comparable information on material issues that can potentially affect short- and long-term value creation.

4.5 For those issues deemed material, SASB identifies industry-specific sustainability accounting metrics that enable a company to characterize their performance with respect to the issue. The metrics may describe impacts as well as opportunities for innovation. Taken together, they characterize a company's positioning with respect to sustainability issues and the potential for long-term value creation.

4.6 Disclosure using SASB's sustainability accounting standards will enable:

- All U.S. publicly listed companies to engage in cost-effective sustainability disclosure;
- Peer-to-peer company comparison by investors and the public;
- Focused efforts by companies to improve performance on material issues;
- A comprehensive view of material sustainability risks and opportunities for investors;
- Public access to sustainability data free of charge via the Form 10-K, 20-F and the SEC EDGAR database

Cost-benefit

4.7 Cost-benefit is an essential element of SASB's proposed sustainability accounting standards. The elements of this analysis that SASB considers include: costs to companies for incremental additional reporting and auditing; the current availability of the information; and the cost savings to companies from more streamlined communication with investors on material issues.

4.8 The benefits considered include the benefits to companies from improving performance on ESG issues that will improve operational and/or financial performance and the related attractiveness to the capital markets. Also considered are the benefits to investors from having readily available, decision-useful information with which to assess portfolio risks and opportunities, and the broader benefits to society from improved market stability and more sustainable outcomes.

5. The Structure of Sustainability Accounting Standards

5.1 SASB provides disclosure guidance and accounting standards on material sustainability issues for use by U.S. and foreign public companies in their annual and other periodic SEC filings (Forms 10-K or 20-F; 10-Q; S-1; 8-K). This chapter provides an overview of the structure of sustainability accounting standards, including: elements of disclosure, description of sustainability accounting standards, examples of additional guidance, and interpretations and technical bulletins.

Disclosure Guidance

5.2 SASB's Disclosure Guidance identifies issues that are material at an industry-level and—depending on the specific operating context—are likely to be material at the company-specific level.

5.3 Companies are ultimately responsible for determining information material to their operations and are required to include such information in their Form 10-K or 20-F and other periodic SEC filings. The Disclosure Guidance provides general guidance on relevant sections of the Form 10-K for disclosure of material sustainability data and information.

5.4 In the exercise of determining industry-level sustainability issues, SASB used a "pure-play" definition of the industry. While this approach is necessary to ensure a coherent understanding of industry drivers and challenges, it does not always reflect the current structure of companies, in two or more industries. Therefore, material sustainability issues of other industries can be material depending on a company's structure, and should be disclosed alongside material issues related to that company's primary industry.

Emerging Sustainability Issues

5.5 In the exercise of determining industry-level sustainability issues, SASB sometimes identifies emerging or forward-looking sustainability issues with strong potential impact on an industry but which are not yet perceived as highly material for a reasonable investor or cannot be cannot yet be reasonably expected to have a material financial impact from a company management's perspective. While emerging sustainability issues are not part of SASB's accounting standards, companies can evaluate the materiality of these issues to their particular situation and choose to disclose their performance on these issues on a voluntary basis.

Accounting Metrics

5.6 SASB's accounting standards provide companies with standardized accounting metrics to account for companies' performance with respect to industry-level material sustainability issues. These accounting metrics should be used by companies in disclosing their performance with respect to each of the material sustainability issues identified as material at the company-level, to ensure that disclosure is standardized and therefore useful, relevant, comparable and auditable.

5.7 Sustainability accounting metrics should also include a narrative description of any material factors necessary to provide context and ensure decision-usefulness of the data reported, including strategy, control, performance, trends, and positioning with respect to peers. This contextual information is essential to interpret disclosures, particularly for quantitative metrics, which alone may not be decision-useful.

5.8 For each sustainability accounting metric, technical protocols provide guidance on definitions, scope, accounting guidance, compilation and presentation to make sure that companies' account of performance on material issues is consistent, comparable and auditable.

Interpretations

5.9 SASB will issue documents known as "interpretations" to explain questions related to sustainability standards as they arise post standards development. SASB will consider issuing an interpretation if there is sufficient interest from stakeholders within an issue that remains unresolved in a sector that has already been addressed in the standards setting process.

Technical Bulletins

5.10 SASB will issue technical bulletins as needed to deal with current topics that are external to the standards-setting process. For example, technical bulletins will be issued in response to issues or questions raised by stakeholders with regard to the use of standards. While the intention will be to provide additional guidance or clarification, they are not expected to impact the substance of SASB's sustainability accounting standards.

6. Implementation

Standards Development

6.1 SASB follows an exhaustive process of evidential data gathering and analysis, in-depth industry research, and engagement and collaboration with a broad range of industry stakeholders. More specifically, the process involves the following phases:

- Preparation by SASB: Evidential data gathering and analysis by SASB's research team, using Evidence of Interest, Evidence of Financial Impact and Forward-looking Adjustment approaches previously described;

- Participation by a multi-stakeholder industry working group: These groups are composed of members with deep industry and market expertise, who provide feedback on the materiality of issues and improve proposed accounting metrics;

- Public notice: SASB releases the list of material issues for a given industry. This makes public notice of the intent to develop accounting standards on this set of material issues. SASB asks for comments and/or additional evidence. Public comment is open for 45 days.

- Exposure draft: SASB publishes the exposure draft of the Sustainability Accounting Standard to the general public via the SASB website and asks for comments. The public consultation period is open for 90 days.

- Standards Council: The Council convenes quarterly, upholding the goal of ensuring consistency, thoroughness and accuracy. The Council reviews the standards development process three times: to review the process of the industry working group, to review the outcomes of the industry working group and to review the exposure draft of the Sustainability Accounting Standard. The Council's final review marks completion of the exposure draft of the Sustainability Accounting Standards.

Auditing

6.2 SASB encourages registrants/filers (public companies) and practitioners (auditing firms) to use AT Section 101 of the American Institute of Certified Public Accountants' (AICPA) Statements on Standards for Attestation Engagements. This provides examples of best practices in auditing to follow when conducting an attest engagement for non-financial data. The Public Company Accounting Oversight Board currently has also adopted this as their "interim" standard for attestation engagements.

6.3 Generally, AICPA sets the final rules for auditing of private companies, while the PCAOB (formed out of Sarbanes-Oxley Act and supervised by the SEC) sets the final rules for auditing of publically traded companies.

Enforcement

6.4 As previously noted, U.S. Federal law already requires publicly listed companies to disclose material information and the SEC has responsibility for enforcement of Federal Securities laws. SASB creates standards for disclosure and accounting of material sustainability information, but it has no mandate for enforcement.

6.5 In addition, SASB is not concerned with performance, which is for the market to decide. SASB's concern is with creating standards that enable peer-to-peer comparison between companies, which can be useful for investment decisions and allocation of capital.

Adoption

6.6 Adoption of SASB's standards will involve a stepped approach involving two phases: beta release and market adoption, and a public release of the standards.

6.7 **Phase I: Beta Release and Market Adoption**. SASB will release its standards in beta, seeking voluntary adoption by both companies and investors. Companies will be encouraged to report on a voluntary basis using the MD&A and other relevant sections of Form 10-K and other SEC filings. Use of SASB standards for disclosure of material ESG impacts provides a concise, cost-effective and comparable way for companies to comply with existing SEC regulation regarding disclosure of material information to investors.

6.8 SASB's materiality-based and industry-specific approach provides authoritative guidance for companies to assess and recognize ESG issues and a standardized method to disclose decision-useful information under the general definition of materiality and within the context of their industry.

6.9 SASB does not aim to duplicate or overturn any issues that the SEC is handling. If the SEC takes action, it will be based on findings that certain key ESG issues or categories of ESG issues are material, regardless of the industry, and warrant a specific inclusion (line item mandate) in the Form 10-K. If the SEC rules unfavorably, it will be based on findings that the ESG issues or categories of ESG issues do not rise to the level of a line item mandate and is therefore not material. In these cases, SASB will not take on the issue, unless it is for specific industries where SASB research has determined it to be highly material.

6.10 Therefore, SASB believes it should develop a strong process to aggregate industry-specific results and identify broad categories of issues that are material for investors, regardless of industry, using a high threshold of materiality and conclusive evidence of mainstream (average) investor interest (see Para. 3.18-3.28 on cross-cutting Issues).

Re-formulation

6.11 From Q4 2012, SASB aims to create industry-specific standards for 80+ industries across 10 sectors within two and a half years. Performance indicators will then be updated annually.

6.12 SASB welcomes public input on potential issues for SASB's research agenda. Specifically, possible sustainability issues material for the submitter's industry. This online solicitation and submission process can be found here:
http://www.sasb.org/engage/suggest-sustainability-issue.

6.13 SASB will periodically maintain its American National Standards, as revisions and updates will be an expected part of the maintenance process. Under Section 4.7.1 of the *ANSI Essential Requirements*, the maintenance of a standard for review and revision must occur within every five years from date of approval of an American National Standard. The periodic maintenance process outlines how to conduct revisions within the public review process.

6.14 Any substantive change made to SASB's Standards will necessitate a public process through ANSI. A substantive change in a proposed American National Standard can be defined as "one that directly and materially affects the use of the standard." Examples of this type of change include:

- "Shall' to "should" or "should" to "shall";
- Addition, deletion or revision of requirements, regardless of the number of changes;
- Addition or mandatory compliance with referenced Standards.

6.15 SASB will set a schedule to address comments received over a period of time. Any part of the standard is open for comment at any time, but SASB will only revise and document consensus action at scheduled maintenance times. SASB will take comments that have been received since the last publication cycle and respond to those comments. Changes submitted to ANSI will occur no more frequently than annually, but no less frequently than 2.5 years.

7. Harmonization

7.1 SASB complements global initiatives including the Global Reporting Initiative (GRI), the International Integrated Reporting Council (IIRC), the Global Initiative for Sustainability Ratings (GISR), the Carbon Disclosure Project (CDP) and others. As many companies publicly listed in the United States are global entities, and many global companies trade on U.S. stock exchanges and must comply with SEC regulations, any reporting mandated by the SEC will have a global impact. Hence, SASB's seeks harmonization of global standards for ease of use by all companies traded on U.S. stock exchanges that choose to do more than disclose the minimum material issues as defined by SASB.

7.2 Cross-cutting issues tend to generate regulatory or voluntary standards on disclosure and SASB must consider this existing body of disclosure standards in the context of its ANSI accreditation and generally to avoid the criticism for a multiplication of standards.

7.3 The goal of harmonizing SASB disclosure standards with existing reporting standards is two-fold: to avoid creating additional costs to companies, and to align SASB's work with global corporate transparency and accountability efforts. When dealing with cross-cutting issues, therefore, SASB will determine the need to adopt existing metrics or develop new ones, based on an analysis of existing metrics.

7.4 To the extent that they appear in different industries, cross-cutting issues will be treated with a consistent (but not necessarily uniform) approach. SASB's analysts will be prompted to recommend identical or similar performance indicators. While the SASB research team will not be constrained to utilize a common performance indicator at the expense of a more suitable industry-specific indicator, harmonization of reporting will be encouraged wherever possible. This important process of consistency and harmonization will also be aligned with existing disclosure standards, wherever applicable.

SASB and Integrated Reporting

7.5 SASB's work of developing industry-specific disclosure and accounting standards on material sustainability issues is complementary with the work of the International Integrated Reporting Committee (IIRC) and the development of an Integrated Reporting Framework (IRF). The two frameworks are fully aligned on many of the core concepts of integrated reporting, including materiality, boundary, accounting for capitals and a principles-based approach.

7.6 Strategically, SASB's work of promoting disclosure of material sustainability issues in annual and other SEC filings of publicly listed companies in the U.S. as a practical implementation of the concept of integrated reporting in the context of U.S. capital markets. In addition, SASB standards provide specific disclosure and accounting metrics to put the concept of integrated reporting into practice. In many aspects, Form 10-K and other mandatory SEC filings for publicly listed companies are the logical platform for Integrated Reporting by publicly listed in the U.S.:

- SEC Filings are the official conduit of material information between companies and investors and one of the main sources of information for capital markets, on which investors base their follow-up information request and valuation models.
- SEC Filings are mandatory for corporations (both U.S. and Foreign) that issue securities to the public in the U.S. Inclusion or omission of information is the ultimate responsibility of senior management, subject to liability of company executives for non-disclosure of material items.
- SEC Filings are a high-level, strategic account of company performance that are intended for the benefit of investors and providers of financial capital (the primary audience of the IRF)
- SEC Filings are meant to present a fair and comprehensive account of companies' performance and ability to create value in the short-, medium- and long-term, including not only operational and financial results but also the management of financial, manufactured and intellectual capitals, governance information and non-financial information that is required to give context to financial results.
- To the extent that the management of natural, human and social capitals is material, as determined by SASB in an industry-specific context, disclosure of company performance in these area is legally required. In addition, forward looking information can be included to address key Content Elements of the IRF, such as Opportunities and Risks, Strategy and Resource Allocation, and Future Outlook. Lastly, the Business Description Section of Form 10-K can be used to address other Content Elements of the IRF including Organizational Overview and Business Model.

Appendix I: Key Definitions

A1.1 **Accounting:** Accounting is concerned with the conceptualization of capital flows, its concrete expression in numbers, as well as budgeting, monitoring and reporting to the capital markets, as defined by the International Accounting Standards Board (IASB).

A1.2 **Disclosure:** U.S. Federal Disclosure requirements are designed to protect the individual investor and therefore, publicly listed companies are required to report their annual public disclosures—information that is necessary for a reasonable investor to make informed investment decisions.

A1.3 **Material information:** Defined by the U.S. Supreme Court as presenting 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. [TSC Indus., Inc. v. Northway, Inc. 426 U.S. 438 (1976)].

Appendix II: SASB Entities and Authority

A2.1 SASB's standards development process is accredited by the U.S. nonprofit organization, *American National Standards Institute, (ANSI).* They have validated SASB's role in creating a system for industries to measure, manage and disclose sustainability performance in U.S. markets.