

## U.S. Companies urged to put natural capital in accounts

June 24, 2012 5:02am

By Mike Scott

Source: <http://www.ft.com/cms/s/0/78e36030-b93f-11e1-b4d6-00144feabdc0.html>

Last week's [Rio+20 summit](#) was, essentially, all about the importance of environmental, social and governance (ESG) issues to governments, businesses, investors and consumers.

But for investors, one of the main problems about these issues is that there is not enough information about them and what there is varies so much from one company to another that meaningful comparison is difficult. At the same time, businesses often provide too much information that is irrelevant to the main challenges that they face.

A new organisation aims to change this – in the US at least. The Sustainability Accounting Standards Board has been set up, and named, to stand as a companion to the Financial Accounting Standards Board, the body that 40 years ago established the Generally Accepted Accounting Principles on behalf of the Securities and Exchange Commission.

“FASB has created very robust, trustworthy markets in the US, but a lot has changed in the last 40 years,” says Jean Rogers, chief executive of the new body. “There is an entire class of information that is increasingly relevant to businesses and investors and that information is not flowing freely. It’s in totally different formats, it’s not standardised, it’s not in a digestible format and investors cannot compare and they cannot benchmark.”

Corporate growth and success are no longer constrained solely by the availability of financial capital, SASB believes.

Rather, global resource constraints and management of environmental and social issues are integral to the long-term success and sustainable value creation of companies.

Issues such as climate change, population growth, urbanisation and shortage of raw materials will have a growing impact on company performance, but because these externalities are inadequately priced, the view that investors have of the performance of resource intensive companies is skewed.

“Forty years ago, companies competed on how well they used financial capital. Now other forms of capital are recognised as important too,” Ms Rogers says. “We cannot have companies that maximise one form of capital at the expense of other assets such as natural capital. Value creation cannot be sustainable if the underlying capital is being depleted.”

ESG information is reported to some degree, but it is not comprehensive and it is not comparable, she adds. And while initiatives such as the Global Reporting Initiative have started to raise awareness about the importance of ESG issues, uptake in the US has been extremely slow. Out of 35,000 listed companies, in 2010 just 183 US groups reported to GRI standards.

“There are very few GRI reporters – and they are the leaders in their fields. Far fewer US companies consider sustainability risks and opportunities than in the rest of the world,” Ms Rogers states. “We want to set a floor, a minimum set of standards for everyone that creates a level playing field.”

In contrast to the GRI, which is an independent body outside of the financial regulatory system, SASB aims to create a new standard for companies that sits inside the existing system.

At the heart of the filing requirements for US listed companies is Form 10-k, a mandatory disclosure form that companies must file with the SEC. Among the issues that must be included is one on risk factors and it is here that SASB hopes to make its mark.

“We are designing standards that should fit right into Form 10-k,” says Ms Rogers. “We hope that every company in a particular industry will know what to disclose so that analysts have enough information to be able to start benchmarking sectors.”

To do this, SASB, which like FASB is a private sector not-for-profit body, is looking at 102 industries, starting with a review of the importance of various ESG issues to different sectors to create a “materiality map”.

“This deliberately narrows our field of vision to the most indisputable issues, so that no one can argue that these factors should not be in Form 10-k,” Ms Rogers adds. “Materiality comes from the perspective of the ‘reasonable investor’. We believe that the reasonable investor wants to know about these things.”

Once these issues have been identified, SASB will work out how to measure, recognise and account for them. The organisation will also look at the links between the factors and value drivers such as growth, return on capital and management quality.

One of SASB’s main aims is to democratise access to ESG information. “There is an information asymmetry out there, some investors can afford it and some cannot,” says Ms Rogers. “We believe that material information is the right of every investor. Your ability to be a market participant should not depend on your ability to access that information.

“The effective functioning of capital markets is based on the idea that relevant information is available to all market participants, and yet there is relevant information that is not available in a useful form. Once it is out there it will drive all sorts of different investment strategies,” she continues.

“This is not just something for institutional investors signed up to the UN’s Principles for Responsible Investment – it’s for any investor that wants to understand the risks and opportunities in our system.”

Once the information is available, organisations such as Bloomberg will back-test it, opening a new window into materiality and creating a new understanding of the magnitude of sustainability impacts.

With investors better able to discern how well companies are positioned in relation to sustainability challenges, the hope is that capital will flow towards more sustainable outcomes.

“Another huge benefit will be that once the information is available, companies will compete to make sure they are not the worst of the lot, creating a race to the top,” the SASB chief argues. “So there is potential to drive behaviour on the corporate side as well, which should mean that the whole pool of investment should improve.”

To ensure rigour, SASB will be working with accounting firms to ensure that there is an auditing and assessment protocol in place so that sustainability information can be audited in line with the way current 10-k forms are audited.

Until the advent of the Sarbanes-Oxley law, FASB was funded by the accounting firms, but now it is financed by taking a small percentage of companies’ filing fees. SASB is not in a position to do that until it can demonstrate that

it is creating value for companies and the capital markets, so at the moment it is funded by private foundations including the Rockefeller Foundation, the Metanoia Foundation and Bloomberg Philanthropies. Eventually it will rely on revenue from licensing, education and training fees to fund work on the industry key performance indicators, which will be updated and published annually.

SASB is timely because it is not just the wider world that has changed: the methodology for valuing companies has also changed dramatically in the last 25 years, Ms Rogers believes.

“Company valuations used to be based on 80 per cent tangible assets and 20 per cent intangible. Now it is the other way round. Intangible assets are recognised as affecting valuations, but they are not easy to quantify. We need next-generation systems that can account for non-financial information, even if you are only interested in financial performance.”

[Copyright](#) *The Financial Times Limited 2012.*