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SASB previews sustainability standards for financials

by David Bogoslaw

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Most public companies now have sustainability programs, but convincing them of the need to report material information on environmental, social and governance (ESG) issues has been a tough sell. That's about to change with the Sustainability Accounting Standards Board (SASB) now developing industry-specific sustainability accounting standards for the disclosure of material ESG issues for the benefit of business, investors and society.

At an educational event at the Bloomberg offices in New York on April 16, SASB provided a preview of its forthcoming standards for the financial sector for an audience of roughly 300 representatives from companies, asset management firms and sustainability-focused nonprofits. Draft standards for the financials sector, the second of 10 sectors that SASB is tackling, will be open for public comments for a 30-day period starting May 1 and are expected to be finalized and released later this year. Health care is the first sector for which SASB developed standards.

SASB plans to develop and release standards for 88 industries over the next two and a half years, launching the process for a new sector each quarter through the first quarter of 2015.

The mantra of participants in the sustainability standards setting process is 'materiality.' Definitions of what is material and what requires disclosure varies according to professional criteria. 'International accounting standards on materiality define it as information that could impact an investor's decisions,' Bob Herz, former chairman of the Financial Accounting Standards Board, said during the first panel on "Materiality and the Reasonable Investor.'

'For the purposes of integrated accounting, [where non-financial issues are reported together with financial data], material is of such relevance to sustainability as to affect or potentially affect a company's business strategy,' he said.

SASB's goal is to spur companies toward better disclosure, offering decision-oriented information that will allow investors to better evaluate the way companies are handling sustainability issues, said Marisa Mackay, associate director of education services at SASB. Currently, the markets reward companies more based on the volume than the quality of their disclosures.

'In our preliminary findings we discovered that as much as 60 to 70 percent of the information in [corporate social responsibility] reports is on immaterial issues,' more like noise that clouds the material sustainability issues for investors, she said. 'We want to reduce the noise to signal ratio in sustainability disclosure.'

In the financial sector, half of the 63 companies surveyed by SASB's Industry Working Group said they currently provide no disclosure on ESG issues in their 10-K filings, with another 14 percent offering only boilerplate statements and 30 percent reporting on industry-specific issues. Just 6.0 percent of the companies disclose ESG metrics. Reporting on performance and goals is virtually unheard of.

SASB meets with the SEC monthly to provide updates on the standards drafting process. After all 88 industry standards are released in 2015, SASB will ask the SEC to adopt them as part of its materiality requirements. SASB is aiming to have them included in the Management's Discussion and Analysis of Financial Condition and Results of Operations disclosure (MD&A) section of the Form 10-K, the only section that doesn't require an outside audit, SASB executive director Jean Rogers told Corporate Secretary at the event.

'That would be a soft landing for us, but a starting point,' she added.

SASB is already working with the Public Company Accounting Oversight Board (PCAOB), which regulates auditors, to come up with standards for the external assurance of sustainability reporting. (PCAOB already has its own external assurance standards.)

Peter Knight, a partner at Generation Investment Management, said his firm uses sustainability as a lens into the quality of a company's management team. He believes SASB standards will change the investment value chain by identifying metrics that allow companies to see where they need to go to adopt best practices that will help them compete better within their peer groups. Over time, these standards will also change how equity analysts are trained to look at companies and will force asset managers to focus more on best practices so they can find misallocations between these and companies' cost of capital, he says.

There's a lot of value to be derived from third party lists such as the best companies to work for, and 'companies compete to be included on these lists, which promotes a race to the top in best practices,' said Dan Hanson, a portfolio manager at Jarislowsky Fraser, and a member of SASB's board. SASB's attempt to quantify some of these intangibles will provide a great opportunity to investors, he believes.

'High quality companies deserve a lower cost of capital than what the market awards them now,' he said. 'The downside risk is in under-managing or mismanaging ESG issues and reporting. The market should assign lower earnings multiples and a higher cost of capital to those companies than it does now.'

In his keynote remarks, Charles Holliday, Jr., chairman of the World Business Council for Sustainable Development and chairman of Bank of America, urged SASB to keep the measures used for sustainability reporting simple in order to be 'absolutely sure that no matter who does the measuring it will be the same.' Though less comprehensive, simpler measures reduce the need for judgment calls and support the main goal of ensuring data that is reproducible and credible, he said.

Far from being a numbers exercise, industry-specific sustainability standards will require a cultural change in most organizations with plant managers setting the tone through their leadership. 'If they aren't setting a different example, if you're just having them fill out forms, you're missing the point,' he said.