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Want to Get Serious About Sustainability? Use SASB’s Standards to Inform ERM

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Global consciousness about sustainability has increased dramatically in recent years. As awareness of the human impact on the health of the planet has grown, so has a widespread recognition of the threat posed by maintaining unsustainable behaviors and processes. The 2017 World Economic Forum’s Global Risks Report shows clear advancement of environmental and societal risks – such as extreme weather events, failure of climate-change mitigation and adaptation, and large-scale involuntary migration – as the predominant risks across the globe.¹
Why Sustainability Matters

Many companies and investors have responded to the rising specter of the risks posed by unsustainable behaviors. Companies increasingly publish sustainability reports that detail the sustainability issues they face and how they intend to address those issues. Investors increasingly demand that companies behave in a sustainable manner.

Companies and investors have good reason to emphasize sustainability, even outside of a pure desire to be responsible global citizens. Studies show that companies rated highly on corporate social responsibility and environmental, social, and governance performance benefit from a lower cost of capital and demonstrate superior financial performance by accounting and market measures.2

However, for many companies, sustainability remains a side topic, not a driving force to be managed alongside other core strategic initiatives. Many executives struggle to address sustainability issues, which can be abstract and which tend to play out over a longer time period than other, more traditional risks. Even those at the forefront of thinking proactively about sustainability sometimes struggle to articulate the business value of their sustainability initiatives.

According to the World Business Council for Sustainable Development (WBCSD), 74 percent of sustainability practitioners agree that management generally views sustainability risks as “less likely and less impactful on a company’s performance” as compared with financial risk, and yet 89 percent believe that “failure to manage sustainability risk could lead to significant impacts on a company’s financial performance.”3

Correspondingly, few companies have taken steps to raise sustainability issues in the context of their broader enterprise risk management (ERM) approach. And, while some companies disclose sustainability issues in their SEC filings, they often do so in a boilerplate manner that is inadequate for investment decision-making. Disclosing sustainability issues in a decision-useful format is a process that requires not only thinking deeply about the risks and their implications for the business, but also raises the stakes for companies to be accountable about addressing those risks.

The Sustainability Accounting Standards Board (SASB) has created a set of provisional standards that identify the disclosure topics most likely to be material for 79 industries, as well as accounting metrics to account for performance. These standards can be used to guide an effort to bring sustainability risks into company ERM frameworks. Moreover, SASB’s standards have been designed to align with SEC filings and to comply with U.S. securities laws, and as such, provide a useful framework for companies seeking to disclose material sustainability information in their legal filings. With SASB standards, companies can focus on the sustainability issues most material to their industry.
Responding to a New Investor Imperative

Investing based on sustainability – often referred to as ESG investing for its focus on environmental, social, and corporate governance factors – once was a peripheral concern. However, it has become a central component of investment analysis across asset classes. This development particularly is true for pension funds and other institutional investors with longer time horizons. According to a 2015 survey by the CFA Institute, 73 percent of portfolio managers and research analysts consider ESG issues in their investment decisions.

Today, investors may exclude companies they think will not perform well, put more weight in companies they anticipate will proactively address sustainability challenges, or invest in companies that, despite current underperformance, can be influenced through proxy voting to change their practices. Investor support for resolutions requesting board oversight of sustainability issues, requests for board committees on human rights, and requests for experts and committees on environmental issues grew more than sixfold between 1990 and 2014. Disclosures of sustainability issues and legal disclosures generally are most aligned in sectors where investors have demanded sustainability information, which underscores how investors can drive change in corporate strategy.

In addition to adapting investment strategies to incorporate sustainability topics, investors are pushing companies to report on their sustainability performance so that they can track the change in performance over time and compare different companies’ sustainable practices.

Despite growing investor interest and activism, research has shown disconnects between companies and investors in terms of confidence in the companies’ ability to quantify the business value of sustainability and how well ESG information is reported. These disconnects highlight the need for a standardized system and a set of reporting metrics.
Growing Prevalence of Sustainability Reporting

Publishing a sustainability report is an increasingly common practice for large, public companies. For example, 82 percent of S&P 500 companies published a sustainability report in 2016.\textsuperscript{10}

Companies are realizing that these sustainability reports not only provide information to their various stakeholders (customers, employees, and investors), but that they also can benefit the company more broadly because of the strategic thinking required to draft such a report. Indeed, a sustainability report can function as a map of future risk\textsuperscript{11} because it reveals the full array of sustainability risks that a company faces. These risks might include environmental, social, human rights, fair labor, and other issues. Ideally, the sustainability report prioritizes which risks should receive the greatest focus from the management team.

Sustainability reporting also sets out specific impact-reduction goals. For example, a goal could state that the company plans to reduce emissions by a certain percentage within 10 years. The report should also delineate how the company will respond to any regulatory changes that may affect its operations from a sustainability standpoint, and detail the policies that will lead to those changes.

While some companies disclose sustainability information in SEC filings, the disclosure is often inadequate. Recent research by SASB shows that 69 percent of companies are already addressing at least three-quarters of SASB disclosure topics for their industry, and 38 percent are already providing disclosure on all SASB disclosure topics. However, more than half of sustainability-related disclosures in SEC filings use boilerplate language, which is not decision-useful to investors.\textsuperscript{12}
What Is Enterprise Risk Management?

Enterprise risk management helps companies specifically identify risks that are broader than any one staff member or department – and to develop appropriate solutions and responses to those risks. An ERM framework defines the approach an organization can take to understand the business environment, identify and assess risks, monitor whether the organization’s exposure in that area is increasing or decreasing, and communicate about the most significant risks – and the company’s approach to mitigating those risks – to its board of directors and other leaders. Companies with mature risk management practices have been found to achieve higher market valuations and outperform competitors financially.13

While ERM is commonly practiced, a 2017 survey by the American Institute of CPAs (AICPA) of members of its business and industry group who serve as chief financial officers (CFOs) or equivalent senior executives found that only 49 percent of public companies and 40 percent of financial services companies – and just 28 percent of all organizations surveyed – believe they have a "complete formal enterprise-wide risk management process in place."14 This finding demonstrates a widespread need for more comprehensive ERM adoption, in which sustainability issues could play a role.
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A Path to Better Sustainability Reporting

Sustainability policies can benefit all stakeholders – across employees, shareholders, customers, and the communities in which companies are based – by promoting faster growth and reducing risk. A number of organizations have developed tools, standards, and frameworks to help companies identify and report on the material sustainability issues they face, including those created by the Global Reporting Initiative; the International Integrated Reporting Council; the United Nations’ sustainable development goals; B-Corporation certification; European Directive on Non-Financial Reporting; and SASB’s standards.

Each of these frameworks can help companies lay out their risks and can help all stakeholders compare different companies’ approaches to addressing the risks over time. However, SASB’s approach is unique in two prominent ways. First, SASB specifically develops its standards so that they are aligned with U.S. securities laws and can be used in mandatory SEC filings. Second, SASB’s standards are industry-specific. This is important because not all sustainability issues are material to all industries, and when they are material, they require industry-specific topics to account for performance. SASB uses a rigorous process to identify the subset of sustainability risks and opportunities that are most likely to have a material impact on companies in an industry. On average, each industry standard has five disclosure topics and 13 accounting metrics.

SASB standards can help U.S.-listed companies report more meaningfully on the sustainability issues that are important to investors. Using a methodical approach including evidence-based research, industry working groups, and public comment periods, SASB has issued standards for 79 industries. With this groundwork, companies can report on the most relevant sustainability topics consistently, enabling comparison over time to their own performance and to peer companies.

As mentioned, much of the disclosure language in legal filings is boilerplate in nature – in other words, vague, nonspecific, and of limited value to investors. SASB’s metrics-based approach facilitates the use of high-quality and detailed information, which can help investors make better decisions.¹⁵
Five Steps to ERM and Sustainability

How can companies begin to incorporate sustainability into their ERM framework and reporting? First, companies should ensure that this issue has the attention and focus of the management team and the board of directors. From there, the following early steps are critical:

1. **Facilitate a discussion between the financial reporting, sustainability reporting, strategy, and enterprise risk management specialists within your organization.** The goals of this discussion should be to help all parties understand the importance of sustainability within the company, bring to light some of the specific sustainability issues that are to be addressed, and begin to clarify the roles different staff members will play in this initiative.

2. **Understand the differences and nuances embedded in the language of sustainability.** In particular, set out clear definitions of the following:
   - **Stakeholders.** This group includes the various people who have a stake in the company, including employees, shareholders, customers, and community members.
   - **Materiality.** This refers to issues that are material to companies in different sectors. SASB has created a materiality map that outlines the specific risks and opportunities by industry and sector.
   - **Opportunity and risk.** Frequently, risk managers focus on the downside of risk. However, sustainability often presents new opportunities, such as cost reductions and new markets.
   - **Impact, likelihood, and speed of onset.** These concepts can enable discussion on the severity of potential risks and how likely a risk event may be. Speed of onset is used to describe how quickly a risk might make an impact.
   - **Appetite and tolerance.** Different leaders and departments have varying views on what is an acceptable amount of risk for the organization. Appetite refers to the desired level of risk, while tolerance refers to the amount of risk the organization is willing to accept.

3. **Document a shared understanding of strategy, objectives, and boundaries.** This will help to establish a clear understanding of expectations and next steps.

4. **Identify cultural challenges and potentially misaligned incentives.** These issues can derail the process if they are not anticipated and proactively addressed. Some incentives might be designed to drive shorter-term business performance but then be in conflict with longer-term sustainability objectives.

5. **Identify opportunities for internal collaboration.** Individuals from different teams across the company can and should work together to advance the company’s sustainability efforts.
Dashboards specifically designed to provide snapshots of sustainability can help management teams and boards of directors quickly assess the initiatives taking place across disparate parts of the company. The exhibits featured here provide examples of how specific dashboards can gather a great deal of information in one place, creating a low-impact way for leaders to remain consistently aware of the organization’s sustainability performance.

**Exhibit 1: Software & IT Services Dashboard**
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Exhibit 2: Automobiles Dashboard

LABOR RELATIONS

Workforce Under Collective-Bargaining Agreements

The company makes a significant effort to involve all employees in the manufacturing process in order to create a work environment that attracts and retains the best talent. Historically, nearly all production workers at ABC Partners have been represented by a union. The work environment is also designed to enhance the employees’ loyalty to the company. The company recognizes the importance of continuous improvement and encourages employees to submit ideas for waste reduction. Employees who participate in the waste-reduction program are rewarded for their contributions.

 Strikes and Lockouts

Although there are occasional strikes and lockouts, the company has not experienced a significant number of them in recent years. In fact, the company has worked hard to maintain a positive relationship with its employees and has been successful in avoiding work stoppages. With the exception of a few minor lockout incidents, no strikes have occurred in recent years.

MATERIALS EFFICIENCY AND RECYCLING

Recycling is an important part of the company’s sustainability efforts. The company has implemented a recycling program that encourages employees to reduce waste and recycle materials. By doing so, the company not only reduces its environmental impact but also saves money. The recycling program has been a success, with significant amounts of waste being recycled.

FUEL ECONOMY AND USE-PHASE EMISSIONS

The company is committed to producing vehicles that are fuel-efficient and environmentally friendly. The company has implemented a number of initiatives to reduce the environmental impact of its vehicles, including the use of alternative fuels and the development of more fuel-efficient engines. The company’s efforts have been successful, with significant improvements in fuel economy and a reduction in use-phase emissions.

FINANCIAL DRIVER IMPACT LEVEL

The company’s financial performance is driven by a number of factors, including the success of its products, the efficiency of its manufacturing operations, and its ability to manage costs. The company has implemented a number of initiatives to improve its financial performance, including the use of advanced manufacturing technologies and the implementation of cost-saving measures. The company’s financial performance has been strong, with significant increases in profitability over recent years.

MANAGEMENT ASSESSMENT

The company is committed to managing risk effectively. The company has implemented a number of initiatives to manage risk, including the use of advanced risk management tools and the establishment of a risk management committee. The company’s approach to risk management has been successful, with significant improvements in risk management over recent years.

PRODUCT SAFETY

The company is committed to producing safe vehicles. The company has implemented a number of initiatives to improve product safety, including the use of advanced safety technologies and the establishment of a safety committee. The company’s efforts have been successful, with significant improvements in product safety over recent years.

Show: Number of Plug-In Electric Vehicle Sales, North America

Show: Percentage of Models Holding Overall 5-Star Safety Rating, North America

Additional Information

Although the company manufactures a wide range of vehicles, each vehicle is manufactured in a factory that is designed to meet the needs of the specific market. The company’s factories are designed to be energy-efficient and environmentally friendly, and the company has implemented a number of initiatives to reduce its environmental impact. The company is committed to producing vehicles that are safe, reliable, and fuel-efficient, and it continues to work hard to improve its sustainability efforts.
Exhibit 3: Data Privacy & Freedom of Expression

Data Privacy & Freedom Of Expression

- % Users Whose Customer Info Is Collected for Secondary Purposes
- Percentage of Customers Who Have Opted In
- Fines and Settlements Associated With Customer Privacy ($ in Millions)
- No. of Gov’t. or Law Enforcement Requests for Customer Information

Dashboard
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SASB’s Standards Help Companies Overcome Inherent Challenges

Incorporating sustainability risks in ERM and legal filings does not come without challenges. Many business managers simply are unfamiliar with sustainability risks. They struggle to rank these risks against more familiar business risks, let alone respond to risks related to sustainability. Moreover, sustainability risks can be difficult to quantify and often involve a longer time horizon compared with traditional risks. Finally, a lack of collaboration between sustainability and risk management teams and insufficient guidance within the predominant ERM frameworks on how to manage sustainability risks also make sustainability reporting challenging.

Committing openly to sustainability often means publicly acknowledging shortcomings, which can make companies vulnerable. By bringing sustainability efforts into public view, companies hold themselves accountable to follow through and succeed on promised initiatives. However, failing to disclose material sustainability information in a decision-useful format has the potential to put companies in a worse position by leaving investors with the impression that the company is ignoring sustainability risks or that it has something to hide. SASB’s standards can help companies identify the most critical issues for their industry and provide a cost-effective, straightforward approach to reporting on them.
Learn More

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