Raising the bar for ESG data

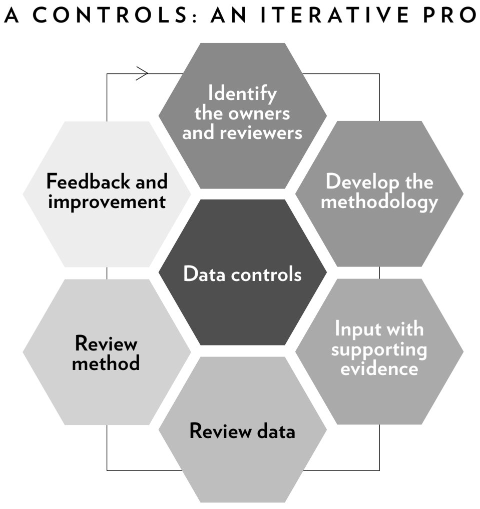
Demand for environmental, social and governance (ESG) or non-financial information continues to grow, but how it is used depends on its quality and reliability. While approaches and levels of integration vary, investors are increasingly considering this data for stewardship, screening and portfolio construction, and in some cases, even fundamental analysis. However, the maturity of ESG data still has some way to reach the robustness and credibility of financial data. For this to be achieved, companies need to take similar steps and methods to those used for financial information to bring them on par.

By Marie Claire Tabone

The role of finance teams

Why should companies improve how they collect and produce ESG data? The motivations for gathering ESG data range from addressing stakeholder demands and regulatory reporting requirements to operational and strategic needs within the business. Improving how the data is collected and measured means that companies can address these different use cases more effectively. As highlighted in the article "Putting ESG data at the heart of a company", the Financial Reporting Council (FRC) Lab (the Lab) explored the practices of over 40 companies for producing ESG data via interviews and roundtables. In these discussions, a key success factor was the involvement of finance teams to help advance how ESG data is considered in a company. Primarily, finance teams have coordinator and reporting roles, but then work closely with the producers and owners directly responsible for sourcing and collecting the data. With finance teams already having a strong overview and links across the business, it makes sense to get them involved to make sure the right data is being collected and is better integrated within the company, avoiding siloed thinking. Familiarity with reporting requirements and the controls environment for financial data means they can apply lessons learned to processing and reporting ESG data. Some finance teams have dedicated ESG specialists, rather than just expanded existing finance roles – however, they can usually tap into past finance experience as well as the expertise of colleagues within the finance division.

DATA CONTROLS: AN ITERATIVE PROCESS



A controls mindset

With the involvement of the finance function, the likelihood of implementing controls and involving risk and assurance or internal audit functions is increased. Whether the systems in place for gathering and processing the data are manual and spreadsheet-based or automated and advanced, companies can put controls in place which will enhance the accuracy and reliability of the data. By creating accountability and audit trails, ESG data can be more confidently used within the business for decision-making. Once the data needed and data owners are identified, companies can take the following steps as part of an iterative process:

- Develop methodology statements for key data points and metrics, describing how they are sourced and calculated in a step-by-step process.
- Provide supporting evidence and confirm metrics were entered or calculated in line with the methodology statement.
- Have an independent reviewer check the data against the evidence provided and the methodology.
- Validate the data via variance analysis and engage internal audit for review of data and assessment of the appropriateness of methodology.

Better controls and clarity on how metrics are calculated can also facilitate external assurance. Management also needs to consider board oversight and put further governance processes in place to ensure that the key metrics are being monitored and escalated as necessary. This will enable better decision-making through monitoring of trends, comparison against targets and using ESG data as inputs into capital allocation decisions. Better internal data should also mean better externally reported data leading to more effective use by investors.

Digital-first approach

Increasingly, standard-setters and regulators are encouraging digital reporting for ESG information. In the UK, a taxonomy was developed to enable digital reporting of mandatory Task Force on Climate-related Financial Disclosures (TCFD) and carbon emission disclosures, and Switzerland has already mandated machine-readable climate disclosures with effect from January 2024. The International Sustainability Standards Board (ISSB) will produce a digital taxonomy alongside its standards and the EU Corporate Sustainability Reporting Directive (CSRD) specifies that companies' sustainability information must be in a digital and machine-readable format. Companies need to prepare for this digital future. Automated tagging of sources allows companies to easily track and pinpoint accurate data, making it more accessible for users, including both investors and regulators. We are aware that investors are already using artificial intelligence (AI), natural language processing (NLP) and application programming interfaces (APIs) to consume and process ESG data. There is inherent uncertainty with these developments and companies must prepare for potential changes in the coming years. Companies need to be agile and responsive, so it is crucial to remain aware of the latest advancements, be responsive to consultations and develop plans for both producing and distributing the data.

Conclusion

While many challenges still exist in producing ESG data, including resource and time constraints and geographical differences, adopting a controls and improvement mindset will help elevate ESG data to a level on par with financial data. It is important to remember that the data is not an end in itself, and for ESG issues, context and narrative are also important. Ultimately, the focus should be on ESG data which is relevant to the business and useful for decision-making.

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The full report from the Lab – Improving ESG Data Production – is available free on the FRC website and provides further recommendations. The Lab is currently exploring how investors obtain and use ESG data, and the role of data providers in its distribution and consumption. The report will be published in summer 2023 and will be available on the ESG data project page.

frc.org.uk/investors/frc-lab/esg-data