Environmental, social and governance (ESG) materiality assessment

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Considering materiality leads to credible ESG disclosures

The business as usual perspective provided by financial reporting is unlikely to communicate the full value in your business.

The May 2017 release of the New Zealand Exchange’s (NZX) new Corporate Governance Code requires issuers to focus far greater attention to the management and disclosure of non-financial risks and opportunities, most notably material environmental, social and governance (ESG) factors.

The gap between what companies are doing and what they are reporting needs closing. ESG reporting can help organisations do this by letting them tell their story on their own terms. This represents a cultural shift from a compliance driven focus to an approach led by organisational activity and stakeholder needs.

However, to be valuable and credible, the development of ESG reporting practices depends on an holistic approach to your material ESG matters, and not merely the extraction (and in some cases extrapolation) of historic ESG data within your organisation.

It is evident and well known globally that businesses adopting robust ESG practices outperform those that do not. The benefits of embracing ESG leads to better management of risks (and opportunities) leading to improved short and long-term value creation.

As well as improved returns, stakeholders and investors now expect companies to provide information describing the frameworks, systems and practices used to manage material ESG matters – as well as the outcomes thereof.
ESG reporting, whether to investors, stakeholders, or for external reporting purposes, is essentially an output of a more comprehensive strategic framework.

Materiality assessments are the vital starting point, from which you manage your non-financial risks - and opportunities.

The figure illustrates that ESG reporting, whether to investors or for external reporting purposes, is essentially an output of a more comprehensive ESG strategic framework focused on material matters.
Materiality assessment as a strategic business tool

Materiality is the principle of defining the social and environmental topics that matter most to your business and your stakeholders.

In our view, materiality assessment should be used as a strategic business tool, with implications beyond corporate responsibility (CR) or sustainability reporting. Organisations can get most benefit from their materiality process by using it as an opportunity to apply a sustainability lens to business risk, opportunity, trend-spotting and enterprise risk management processes. Rather than creating a separate, isolated process, leading companies embed sustainability thinking within existing processes.

A broad and inclusive materiality process, including stakeholder engagement, can deliver benefits such as:

— Ensuring business strategy takes into account significant social and environmental topics, and the management of sustainability issues is embedded in wider business processes.

— Identifying trends on the horizon, such as water scarcity or changing weather patterns, that could significantly impact your company’s ability to create value in the long-term.

— Prioritising your resources for the sustainability issues that matter most to your business and stakeholders, so you can focus time and money on the most important topics, and on collecting relevant data.

— Highlighting areas where you need to manage and monitor risks that are important but not currently addressed.

— Identifying the areas of interest to the most important stakeholders, enabling you to report concise information that gives a meaningful picture of progress to those who need it.

— Helping to identify where your company is creating, or reducing, value for society.

Materiality can be used for any combination of the following:

1. **Communication**
   - The structured and documented approach facilitates high-level communication about the most material topics inside and outside of the organisation.

2. **Vision and strategy**
   - Support in the development of your non-financial strategy.
   - Basis for identifying the risks and opportunities in relation to ESG.

3. **Reporting**
   - Generation of ESG reporting content and global standards compliance.
   - Identification of strategies and initiatives to capitalise on ESG issues.

4. **Future Trend-Spotting**
   - Identifying new expectations that may become relevant to the company’s business in the future.
   - Discuss and prepare for new expectations from stakeholders.
KPMG’s Materiality Approach

KPMG has developed a unique, globally adopted 7-phase sustainability materiality assessment framework. The phases are:

PHASE 1: DEFINE PURPOSE AND SCOPE
Define what materiality means for your organisation and be clear about your objectives and audience.

PHASE 2: IDENTIFY POTENTIAL TOPICS
Create a long list of potential material topics.

PHASE 3: CATEGORISE
Refine the long list of potential material topics by clustering them into categories.

PHASE 4: GATHER INFORMATION ABOUT THE IMPACTS AND IMPORTANCE OF TOPICS
Explore each material topic in detail to understand its relevance to the business and stakeholders.

PHASE 5: PRIORITISE
Prioritise material topics based on the strategic importance to the business, importance to stakeholders, economic and environmental impact of each topic in the value chain.

PHASE 6: ENGAGEMENT MANAGEMENT
Test the results of your materiality assessment with key internal audiences to validate the outcome.

PHASE 7: SEEK STAKEHOLDER FEEDBACK
Follow-up with stakeholders to get feedback on the material topics reported.

In 2014, KPMG prepared a dedicated guide in response to the growing focus on materiality in reporting frameworks and accounting standards such as the Global Reporting Initiative’s (GRI) G4 guidelines and the International Integrated Reporting (<IR>) Framework.

KPMG’s approach is aligned with the GRI G4 guidelines and is able to be tailored to apply in an <IR> context.

https://assets.kpmg.com/content/dam/kpmg/pdf/2014/10/materiality-assessment.pdf

Both GRI and <IR> have a similar approach to materiality in that they are both principles-based. Both frameworks put an emphasis on the process.