



cutting through complexity

KPMG INTERNATIONAL

Sustainable Insight

The essentials of materiality assessment

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Introduction

Materiality is the principle of defining the social and environmental topics that matter most to your business and your stakeholders. Some 80 percent of the world's largest 250 companies already identify material sustainability issues in their reporting.¹ Yet the process of identifying material issues is a challenge that clients of KPMG member firms are increasingly seeking our professional guidance on.

This is primarily due to the growing focus on materiality in reporting frameworks and accounting standards, such as the Global Reporting Initiative's (GRI) G4 guidelines, the International Integrated Reporting <IR> Framework and the Sustainability Accounting Standards Board (SASB) in the US.

In addition, new regulation - such as the European Directive on non-financial reporting² - and increasing stock exchange requirements to report environmental, social and governance (ESG) risks³ are leading companies to consider what non-financial information matters and what they should report.

As a result, many companies are looking to revise and update their materiality assessment processes. While many large companies understand the principles of materiality, some struggle to define and implement a robust process. This is reflected in the fact that of the 250 largest companies in the world (by revenue) that define material topics in their sustainability report, 41 percent do not explain the process used and less than half (45 percent) clearly explain how stakeholder input is used to identify material topics.⁴

Common challenges with the materiality process include: incorporating and prioritizing stakeholder views, involving senior management, and extending the materiality

assessment beyond the company's own operations, across the value chain.

We believe that in many companies the sustainability materiality process can be significantly improved, better aligned with wider business processes and reported with more clarity.

This paper aims to help companies by providing guidance on the materiality assessment process in the light of recent developments in reporting requirements and advice on overcoming common challenges. We set out the key steps companies need to take to establish a robust process and provide solutions to common challenges.

The paper is written primarily for sustainability professionals, risk managers and those involved in corporate reporting.

We believe that the companies which fully consider how sustainability topics interrelate with their business strategy, and develop sustainability materiality processes that link with the wider enterprise risk management process, will be in a better position to inform investors, regulators and other stakeholders on their environmental, social and governance impacts, risks and opportunities.

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- 1 KPMG (2013). *The KPMG Survey of Corporate Responsibility Reporting 2013*.
 - 2 In April 2014 the European Parliament adopted the directive on disclosure of non-financial and diversity information. It affects around 6,000 large companies in Europe that will need to disclose information on policies, risks and outcomes related to environmental and social issues, human rights, anti-corruption, anti-bribery and diversity. http://ec.europa.eu/internal_market/accounting/non-financial_reporting/index_en.htm. Retrieved 20 October 2014.
 - 3 KPMG, United Nations Environment Programme, Global Reporting Initiative and Unit for Corporate Governance in Africa (2013). *Carrots and Sticks: Sustainability reporting policies worldwide*.
 - 4 KPMG (2013). *The KPMG Survey of Corporate Responsibility Reporting 2013*.



04

KPMG's guide to the materiality process



11

Improving your materiality process: overcoming challenges



17

How we can help

In this paper

4

KPMG's guide to the materiality process to help you navigate the complex landscape of stakeholder expectations, risks and opportunities. It is designed to be a practical guide on the process relevant to all organizations – regardless of how established your sustainability strategy and reporting is.

11

Strategies to help resolve common challenges you might face while completing a materiality assessment, from prioritizing stakeholder views to involving senior management.

17

KPMG's Materiality Toolkit and Methodology

Materiality assessment as a strategic business tool

In our view, materiality assessment should be used as a strategic business tool, with implications beyond corporate responsibility (CR) or sustainability reporting. Organizations 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 within these existing processes.

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

- Ensuring business strategy takes account of 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
- Enabling different functions of the business to be ready to take advantage of opportunities to develop new products or services and stay ahead of competitors
- Prioritizing your organization's 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 issues 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 that need it
- Helping to identify where the company is creating, or reducing, value for society.

KPMG's guide to the materiality process



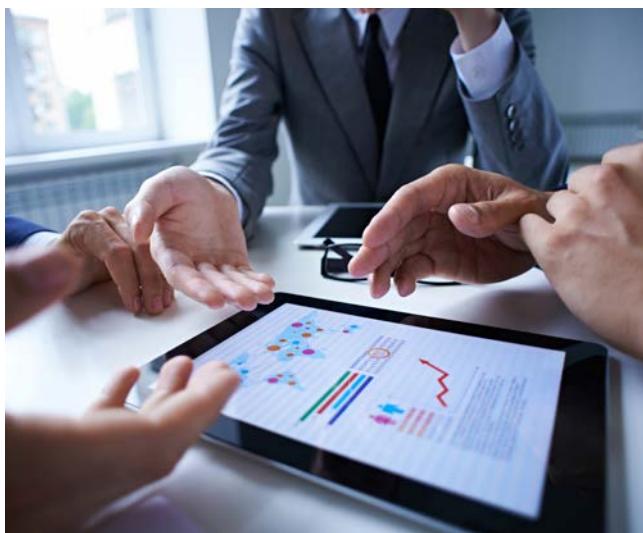
Materiality assessment is the process of identifying, refining, and assessing numerous potential environmental, social and governance issues that could affect your business, and/or your stakeholders, and condensing them into a short-list of topics that inform company strategy, targets, and reporting.

We provide a 7-phase materiality process, aligned with KPMG's Materiality Toolkit and Methodology. We have prepared this guide and toolkit based on member firm professionals' extensive experience in advising clients, working with enterprise risk management teams and assuring materiality processes. It includes key points to address in each phase, split into two parts: the first part explains the expected elements that we believe are minimum requirements for a robust materiality process. The second part provides more advanced steps for organizations with a more established sustainability strategy.

You can expect that your third-party assurance providers will look for documented evidence of each step.

Aligning your materiality process with reporting frameworks

There is no one universally agreed definition or approach for determining material topics, leaving companies free to develop their own approach. KPMG's approach is not designed to adhere to one specific reporting framework. It is aligned with the principles of the GRI G4's process, and can be tailored to apply in an Integrated Reporting context. In member firms' experience, companies often struggle to navigate the different requirements of reporting frameworks. We believe it is possible to have one reporting process and to produce one primary report to communicate material topics:



- Both <IR> and G4 have a similar approach to materiality in that they are both principles-based, rather than rules-based. Both frameworks put more emphasis on the process of the assessment, rather than setting any requirements for the outcome of a materiality assessment.
- KPMG has analyzed the two materiality definitions and we believe that if value creation is the common denominator to filter material topics then a bridge can be established between the two definitions.

For companies in the US, whilst SASB's sector approach may provide insights into the material topics investors may expect your organization to report on, you will still need to perform your own materiality assessment. Doing so will give you vital information on stakeholder views and enable you to identify material topics relevant to your particular geographies and business model.

More information on the alignment between two global, well-known reporting standards can be found in: **Bridging the gap between Integrated and GRI G4 Reporting** (KPMG, September 2014).⁵

⁵ <http://www.kpmg.com/za/en/issuesandinsights/articlespublications/risk-compliance/pages/bridging-the-gap-between-ir-and-gri-g4-reporting.aspx>.

KPMG's guide to the materiality process



Source: KPMG (2014). Sustainable Insight: the essentials of materiality assessment.

PHASE 1:



Define purpose and scope

Define what materiality means for your organization and be clear about your objectives and audience

Expected

- **Define the objectives of the materiality assessment.** Consider what you will do with the outcome of the process. Objectives could include:
 - Identify key environmental, social and governance risks and opportunities for your organization
 - Refine sustainability strategy
 - Inform wider business strategy
 - Identify the most important topics to be covered in the sustainability report or integrated report
 - Engage with internal or external stakeholders
 - Identify future trends that could impact your company
 - Identify areas for target setting to improve business and sustainability performance
- **Consider your audience:** Who is the key audience for the outcomes of your materiality process? Is it the Board of Directors, those who read your sustainability report, or others?
- **Define what 'materiality' means for your organization.** Consider three key questions:
1) Is the topic of importance to your stakeholders? 2) Does the topic have a social, economic, or environmental impact in your value chain? 3) Is the topic of strategic relevance to your business?
- **Define the organizational scope of material topics:**
 - Consider the regions or countries of operations to be assessed in the materiality process. The assessment could provide a global view or a view of specific geographies.
 - Define which parts of your business the assessment will cover. It could relate to certain business units, or be performed at group level.
 - Define the boundary of the materiality assessment by considering material topics across the entire value chain e.g. operations, upstream, downstream.
 - Decide how the outcome of the materiality process will feed into reporting – standalone sustainability reporting or integrated reporting.

Advanced

- **Embed materiality** as an integral part of management cycles and business strategy: include materiality assessment results when planning the business strategy and setting performance objectives.
- **Manage impacts beyond operational control:** In order to meet the GRI G4 guidelines, all reporters must disclose the 'boundary'- where the most significant impact of each material topic occurs (inside or outside the organization). We would expect more advanced organizations to have a detailed strategy for improving impacts beyond the company's own operations e.g. for improving environmental impacts of products downstream.

PHASE 2:



Identify potential topics

Create a long-list of potential material topics

Expected

- **Review sources to create a long-list of potential material topics**, including: media reporting, internal data, external peer review, sector-specific regulations and standards (e.g. Roundtable for Responsible Soy, International Council for Mining and Metals), ratings and rankings (e.g. Dow Jones Sustainability Index, Carbon Disclosure Project) and research on wider social and environmental trends and challenges.
- **Assign responsibility** for compiling the long-list of material topics and consider who outside of the sustainability team should be involved e.g. enterprise risk management team, senior management. Involving business functions beyond the sustainability team will provide wider perspectives and more in-depth understanding of trends affecting the business.
- **Include areas of opportunity** (such as cost savings, efficiency gains, new revenue streams from green products), in addition to risks.
- **Consider external stakeholder engagement**. Explore which external stakeholders you should interact with to get the most valuable feedback. Take into account the impact stakeholders have on your company, as well as the impact your company has on them, and focus on those stakeholders where the impact is greatest.

Advanced

- **Establish a continuous process** for capturing changes to relevant topics (for both emerging issues and longer-term future issues), as part of an embedded approach.
- **Establish a trend-spotting process** to collect material topics based on risks and opportunities reported from local entities to group level.
- **Invest in a digital solution** for collecting and storing all evidence and documentation.

PHASE 3:



Categorize

Refine the long-list of potential material topics by clustering them into categories

Expected

- **Cluster topics** into a limited number of higher level categories. Use a level appropriate to the unit of assessment e.g. group, country, business unit, site level.
- **Check that the categories are on the same level** and that some categories are not more granular than others e.g. social and environmental trends, topics, sub-topics.
- **Align topic names** with existing terminology, strategy and policies used by your company.
- **Make sure everyone involved in the process understands the specific risk or opportunity** for each material topic and describe each topic clearly.

Advanced

- **Connect every material topic to relevant external trends**. Ensure that your company can articulate how social and environmental trends impact both corporate and societal value now, or could in the future.
- **Consider how material topics are connected and overlap** to influence each other, clustering issues in a systemic risk and opportunities map (see page 16).

PHASE 4:



Gather information about the impact and importance of topics

Explore each material topic in detail to understand its relevance to the business and stakeholders

Expected

- **Gather information about the relevance of each material topic so you have the information you need to prioritize topics in the next phase.** Steps include:
 - Consider the relevant stakeholders for each topic and assess the importance of each topic to them.
 - Define the methodology you will use to 'score' each topic.
 - Assess the strategic importance of each topic to the business. Consider how critical each topic is for the business in terms of: executing strategy; current and future risks; and market opportunities and product innovations. If possible, use the same thresholds used by enterprise risk management when conducting a materiality assessment, taking impact on corporate value creation as the basis for assessment.
- **Assess the actual and potential economic, social, and environmental impacts** of each of the topics to get an understanding of the impacts.

Advanced

- **Quantify economic, environmental and social impact** on the basis of a comprehensive assessment model, using a methodology such as KPMG True Value.⁶

PHASE 5 :



Prioritize

Prioritize material topics based on the strategic importance to the business, importance to stakeholders and the social, economic and environmental impact of each topic in the value chain

Expected

- **Prioritize material topics by:**
 - Identifying relevant business functions and deciding which internal stakeholders should be involved in prioritizing topics. Is every category linked to a relevant business function that is involved in prioritizing the final topic list? Are the business functions involved in assessing and prioritizing topics sufficiently senior and knowledgeable to provide meaningful insight?
 - Using the methodology developed in phase 4 to 'score' each topic. Prioritize stakeholder views by assessing the relative importance of each stakeholder. Use the information gathered on stakeholder views in phase 4. Prioritize topics based on the business impact by assessing the economic, social and environmental impact of each topic on your company's value.
 - Setting a threshold or cut-off point for defining which topics will be considered material. If possible, use the same thresholds used by enterprise risk management when conducting a materiality assessment, taking impact on corporate value creation as the basis for assessment

Advanced

- **Work with enterprise risk management function** closely to prioritize material social and environmental topics as an integral part of company-wide risk management.
- **Develop a scoring methodology** to weigh the input from various sources and stakeholders to refine a long-list of topics.

6 For more information visit kpmg.com/truevalue

PHASE 6:



Engage management

Test the results of your materiality assessment with key internal audiences to validate the outcome

Expected

- **Ensure that the materiality assessment is signed off by senior business management.**
Define senior managers based on the scope of your assessment. For instance, for a company level assessment, this should at a minimum involve the executive in charge of sustainability and the relevant divisional managers.
- **Review is necessary to ensure the process and outcome are considered credible** both internally and externally and that management has accepted the results and considered the implications.

Advanced

- **Present outcomes** of the materiality assessment to the Board of Directors.
Recommend what action the board should take as a result of the assessment.
- **Feed the outcome of the materiality analysis into wider corporate strategy review.**
Include the implications of identified social and environmental trends and their potential impacts on the business in the corporate strategy process.

PHASE 7:



Seek stakeholder feedback

Follow up with stakeholders to get feedback on the material topics reported

Expected

- **Identify stakeholders** to review the material topics published and evaluate the outcome of your materiality assessment before you repeat the process.
- **Document results** from stakeholder input and describe the impact this will have on future reporting, based on a due process with proper sign-off by senior management.

Advanced

- **Establish a stakeholder panel** to give feedback on your materiality outcomes and make sure your materiality assessment process is sound.
- **Seek to further integrate the results** of the materiality assessment in company strategy, governance, operations and reporting.

Improving your materiality process: overcoming challenges



Regardless of whether your organization has an established sustainability strategy and material topics, or you are completing a materiality assessment for the first time, the process can be challenging. In this section we explore some of the common issues our member firm clients have faced, along with KPMG's advice on how to overcome them.

Eight challenges



CHALLENGE 1:

The materiality assessment process is isolated from the rest of the business

It can be tempting to treat materiality as a means to an end: a necessary exercise to produce a materiality matrix for your sustainability report. However, to get the most from your materiality assessment process, it's essential to go outside the sustainability team and involve people from right across the business.

KPMG's guidance: An isolated process has limited potential to protect and create value for the company
The materiality assessment process can give you insights that are too valuable to stay within the sustainability team alone – understanding current and future risks and opportunities should be the starting point for any sustainable business strategy. Consider extending responsibility for the materiality assessment process throughout the organization as a medium-term goal. In the short-term, start by involving managers in different functions (e.g. tax, human resources, sales) through interviews. Over time, progress to involving them in tracking material topics, eventually transferring ownership to them for relevant topics.

CHALLENGE 2:

Senior management is not involved in the materiality assessment process

It can be challenging to get senior management interested in the materiality assessment process or aware of the outcomes, yet senior level buy-in can significantly improve the outcome. It can also help prevent materiality assessment from being restricted to the sustainability team.

KPMG's guidance: Discuss the materiality assessment process in terms of business value

We would advise discussing materiality in terms of the implications of topics on corporate value creation – on revenues, cost and risks. Gradually build top level management engagement, firstly by involving them in the process from the start, through interviews, or a workshop to discuss trends affecting the business. Later, before the results of your materiality assessment are made public, seek formal management-level sign off on material topics to ensure there is company-wide support for the process and outcomes.



CHALLENGE 3:

The business is too complex for a meaningful materiality assessment

The GRI's G4 Guidelines have led many companies to extend the boundary of their materiality assessment beyond operational control to consider the importance and impact of issues across the value chain from upstream in the supply chain to downstream product use and disposal. Large multinational companies have the added complexity of operating in multiple countries and across different business units with very different supply chains, products and customers. Producing one list of material topics that reflects opinions and interests across diverse parts of the business can seem impossible.

KPMG's guidance: Ensure the scope of your materiality assessment reflects the reality of your business

There are many ways to slice a materiality assessment. Make sure the scope of your assessment reflects the reality of your business by focusing on the core business processes and activities, or the most significant geographies. Don't try to cover the entire value chain for every business unit in every country at first. Another approach is to set a group level framework for materiality assessment at the corporate center, while identifying material topics at business unit level. A group level framework gives consistency in the materiality approach, but can be adapted to the different operational environments.

CHALLENGE 4:

Stakeholder engagement is time consuming or costly

For large multinational companies, the list of potential stakeholder groups can be very long as your business interacts with hundreds of groups each year, both inside and outside the organization. It can seem a huge task to involve these stakeholders in your materiality process to ensure their views and opinions are heard.

KPMG's guidance: Focus on your business's existing stakeholder interactions

Stakeholder engagement improves the quality and credibility of your materiality process. While specific engagement activities can help you identify material issues, a lot of valuable input can also be taken from existing sources and engagement channels such as employee or client satisfaction surveys or interviews. Your company's day-to-day stakeholder interactions as part of normal business are just as valuable as one-off stakeholder activities. Asking external stakeholders to rate the importance of topics to them will give you useful insights into their concerns and priorities, but don't rely on external views alone to shape your assessment. Consider the views of internal stakeholders by asking them to rate and prioritize the importance of topics to the business.



CHALLENGE 5:

Stakeholders are interested in every topic, so which topics are material?

Your stakeholders may expect that you treat all opinions equally, but in practice there are too many views and issues raised by internal and external stakeholders, so some level of prioritization is needed.

KPMG's guidance: Rate stakeholder views with a straightforward and not overly complex approach

A simple and not overly complex process for weighting different stakeholder views will help you refine a long list of material topics into something meaningful that fairly reflects views. One approach could be to rate stakeholder views as high, medium or low against set criteria such as:

- Can the stakeholder significantly impact your business's ability to create corporate value?
- Is the stakeholder representing a large group with a legitimate concern, based on societal impact of the issue?
- Can the impact of the topic be reasonably assessed (quantitatively or qualitatively)?

CHALLENGE 6:

Material topics are too broad or overlap

Many companies define material topics in broad terms, sometimes overlapping subject areas or failing to define an issue properly. This makes it difficult for stakeholders to evaluate whether your business is managing the right issues or not.

KPMG's guidance: Define topics at a level that reflects your organization and your communication goals

Try to define material topics at a level that is relevant to your organization and that serves the purpose of your materiality assessment. Avoid mixing different levels of topics e.g. broad topics (environment), with specific sub-topics (improving energy efficiency of products). Different levels of definition could be:

- Social and environmental megaforces: high level macro trends that affect your business e.g. climate change, urbanization, resource scarcity
- Topics: defined issues or topics that can be managed e.g. energy use, workforce diversity, supplier safety
- Sub-topics: more specific topics e.g. a specific risk or opportunity for your business
- Metrics: Within different levels of topics, you may also identify metrics used to track your progress and performance.

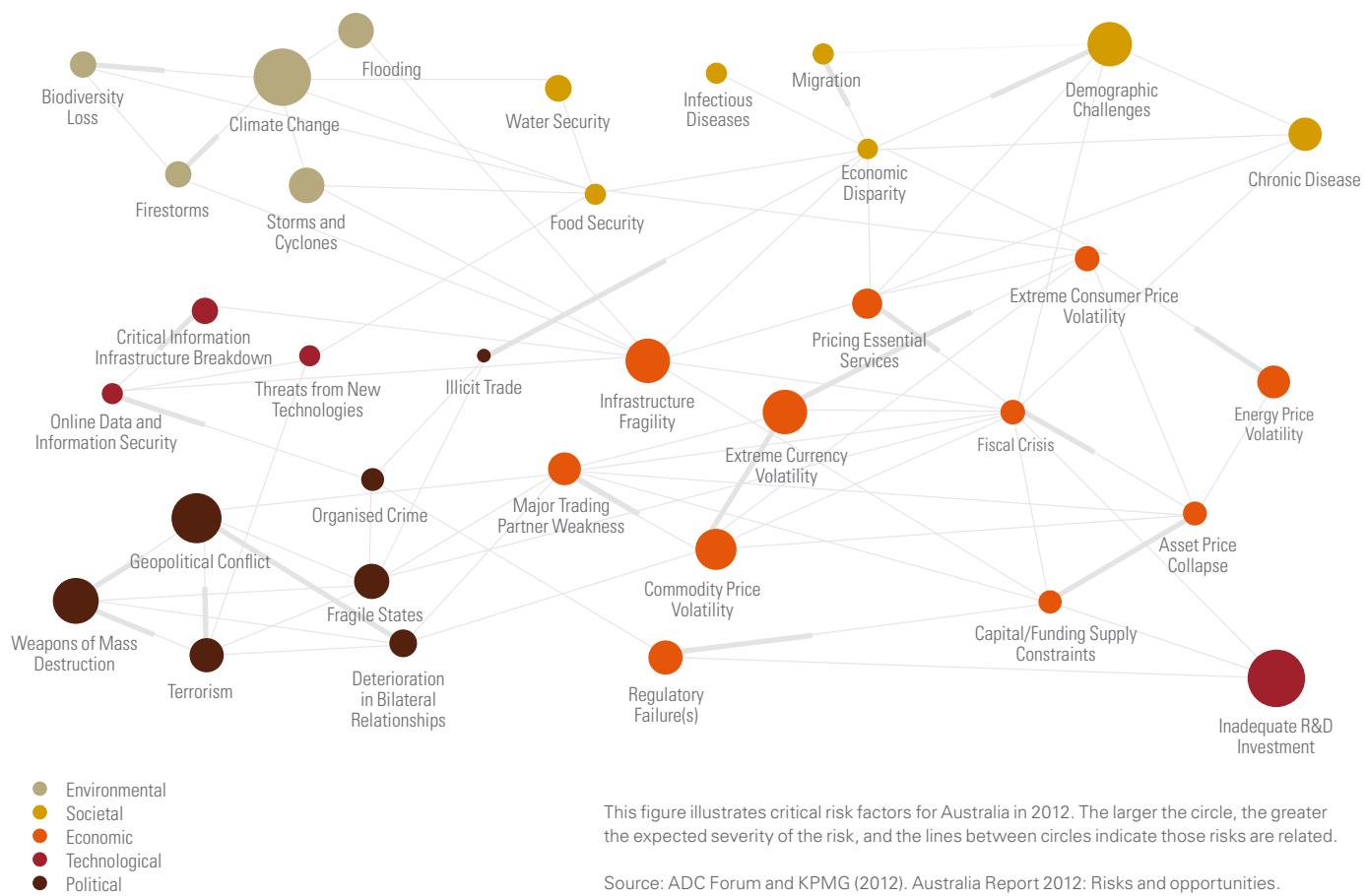
We recommend using different levels to communicate your priorities for different purposes. For instance, in an internal stakeholder engagement workshop you may get more meaningful responses to specific sub-topics. When discussing your business strategy with senior management, it may be more relevant to discuss

social and environmental changes with implications for the wider business. For an external audience, you might choose to organize information for readers of your sustainability report in chapters for each topic. Whatever level you chose, be consistent when communicating your material topics.

Taking materiality to the next level: identifying interconnections and systemic risks

One approach to identifying material topics that KPMG member firms have trialled with clients is to cluster issues together in a systemic risk and opportunities map. This approach takes the definition of material topics and adds to it the consideration of how topics are connected and overlap to influence each other. By clustering related topics together into broad themes, it is possible to address the interconnectedness of risk drivers which are most central and impact the ability of strategic business priorities to withstand, recover and adapt from stress. For example, one trend such as climate change could be connected with significant risks such as biodiversity loss, flooding, water security and food security, which in turn could impact price volatility and economic disparity. We believe that a systemic risk and opportunity map provides clients with a more nuanced understanding of the potential impacts of economic, social and environmental changes on corporate value and resilience now and in the future.

Figure 1: Risk interconnectivity



7 ADC Forum and KPMG (2012). *Australia Report 2012: Risks and opportunities*.



CHALLENGE 7:

There are more material issues than the organization can manage

For organizations that have assessed materiality several times, it can be common to see the list of material topics growing every year as new issues emerge, and with it, the amount of information reported to stakeholders. However, the larger the number of material topics you have, the harder it is for stakeholders to understand your impacts and your priorities.

KPMG's guidance: Don't be afraid to prioritize

Few businesses are capable of managing a large number of topics at the same time with proper attention and senior management involvement. Weighting stakeholder views will help you prioritize the topics that are most material and if you find you still have a very long list of topics, it could be that your threshold for what is considered material is set too low. Don't be afraid to identify fewer material topics – your stakeholders will appreciate a more concise picture of the key issues for your business and your performance. Raising the threshold could in turn reduce the burden and cost of collecting unnecessary information and data.

CHALLENGE 8:

The value of repeating a materiality process each year is not clear

From conversations with clients, we know many organizations do not see the value of conducting a materiality assessment every year, and there can be confusion over the right frequency of assessment.

KPMG's guidance: Establish an ongoing process for capturing risks, opportunities and stakeholder views

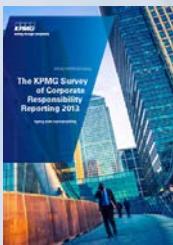
There is no agreed frequency for materiality assessments that works for every company and KPMG professionals would not advise every company to complete a full materiality process every year. For the majority of companies, material topics don't change significantly from one year to the next, although some topics may shift slightly in importance. In some industries, issues may change more quickly than in others so it's important to find a frequency that matches the pace of change in your sector. A more streamlined interim update could be enough to capture new issues or changing topics. Having an ongoing assessment process that also captures emerging risks, opportunities and stakeholder views across the business is more important than performing a detailed reassessment at regular intervals. Ensuring that your materiality process is integral to the wider business strategy by involving colleagues in the strategy and risk management departments, will ensure emerging risks or opportunities are not missed.

How we can help

KPMG is one of the pioneers of sustainability consulting and assurance – some KPMG member firms first offered sustainability services over 20 years ago – which gives KPMG's network a level of experience few can match. Today member firms employ several hundred sustainability professionals located in around 60 countries.

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The KPMG Survey of Corporate Responsibility Reporting 2013

Find out more about corporate responsibility (CR) reporting trends across 41 countries and learn from leading companies that produce high quality CR reports.
kpmg.com/crssurvey

Local knowledge, global experience

Our global network of member firms means KPMG firm professionals recognize the economic, political, environmental and social landscapes wherever your organization may operate. At the same time, our member firms are closely connected through our global Center of Excellence. This means that, whatever challenge you face, we can put together a team with international experience to help you.

Sustainability Plus

We don't work in a sustainability vacuum. We work side-by-side with colleagues from tax, audit and advisory including sector specialists, management consultants, tax advisors and experts in IT, supply chain, infrastructure, international development and more. This means you can benefit from a hand-picked multi-disciplinary team.

Results-driven

KPMG member firms help clients to develop future-fit business strategies based on solid understanding of the issues. We strive to think big and challenge convention, but with implementation in mind, working with you to find practical approaches that can create success and growth through change.

Through our assurance services, we assist you in delivering transparent disclosures whilst progressing performance and reporting through challenging observations and related recommendations for improvement.

Foresight needs insight

Our global Center of Excellence focuses on thought-provoking research, analyzing drivers of global change and developing practical business responses that you can apply within your own organization.

KPMG's Global Materiality Methodology and Toolkit

Using KPMG's global network of sustainability expertise, we have developed a materiality methodology and toolkit to guide you through materiality assessments. KPMG member firms have extensive experience in advising clients on getting the most from materiality, by integrating the process with risk identification and enterprise risk management processes, as well as business strategy.

Our approach is structured, yet flexible, and can be customized to your needs, while meeting external requirements. Developed with a technology partner, the KPMG Materiality Toolkit provides a software solution to support you on each step of the materiality assessment process and outcomes.

For example, KPMG professionals can tailor an approach for your first materiality assessment, or help more advanced organizations to align materiality outcomes with the wider business strategy. We believe that materiality assessment is much more than a reporting exercise. It is the foundation for your sustainability strategy, target-setting, stakeholder engagement and performance management.

KPMG member firms can help your organization to:

- Design and deliver your first materiality assessment
- Develop governance structures around the materiality process and engage senior management
- Review your materiality process or outcomes and assist you with updating them
- Provide third party assurance or a pre-assurance readiness assessment of the materiality process and outcomes
- Develop your sustainability strategy and benchmark it against your peers
- Integrate sustainability topics into the wider business strategy and risk management functions
- Use the materiality assessment results to define your sustainability reporting or integrated reporting content.

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