

*Making materiality determinations in the ...*



# MultiCapital Scorecard™

Rethinking Organizational Performance

*The world's most advanced (and open-source)  
Triple Bottom Line performance accounting system*



THOMAS & MCELROY LLC  
Advisors in Organizational Sustainability

# Contents

	Page
• Executive Summary	1
• Multicapitalism: <i>The New Economics</i>	2
• Materiality in the MCS	4
• Duties and Obligations	8
• MCS Materiality Template with Examples	12
• Appendix: Definitions of Vital Capitals	19
• Contact Information	25

# Executive Summary

- The MultiCapital Scorecard (MCS) is the world's first and only multicapital- and context-based integrated measurement and reporting system
- Materiality in the MCS, like sustainability, is determined by reference to norms or standards for organizational impacts on vital capitals:
  - Materiality pertains only to impacts on vital capitals
  - An impact is material if it corresponds to a duty or obligation an organization has to manage its impacts on capitals in ways that can affect stakeholder well-being
- Materiality determinations follow a 2-step process:
  1. *Absolute Materiality* identifies impacts that must be included in measurement, management and reporting
  2. *Relative Materiality* then further qualifies the same impacts in terms of their priority, size, etc.



# **Multicapitalism: *The New Economics***

# Expressions of Multicapitalism

*“Value created by an organization over time manifests itself in increases, decreases or transformations of the capitals caused by the organization’s business activities and outputs.”*

International Integrated Reporting Council (IIRC),  
*<IR> Framework, 2013*

*“Ultimately value is to be interpreted by reference to thresholds and parameters established through stakeholder engagement and evidence about the carrying capacity and limits of resources [i.e., capitals] on which stakeholders and companies rely for well-being and profit, as well as evidence about societal expectations.”*

IIRC Background Paper, *Value Creation*, 2013

See article [The Carrying Capacities of Capitals](http://www.greenbiz.com/blog/2013/06/18/carrying-capacities-capitals) for more information:  
<http://www.greenbiz.com/blog/2013/06/18/carrying-capacities-capitals>



# **Materiality in the MCS**

# Materiality in the MCS

- **Basic materiality principles in the MCS**
  - Materiality is only about impacts on vital capitals vis a vis the role they play in support of stakeholder well-being
  - Organizations, in turn, have duties and obligations to manage their impacts on vital capitals so as to help ensure stakeholder well-being
  - An impact on vital capital, therefore, is material if it corresponds to a duty or obligation owed to stakeholders, whether the impact is already occurring or not
- **MCS Materiality determinations occur in 2 steps**
  1. *Absolute Materiality* determinations
  2. *Relative Materiality* determinations

# Materiality in the MCS (cont.)

## 1. Absolute Materiality

- Materiality in performance measurement and reporting is a binary question: a thing is either material or not
- The “things” of interest in MCS are impacts on vital capitals
- Absolute materiality determinations, therefore, are required to determine which impacts on vital capitals should be included or excluded in a program or report
- In MCS, if an impact on capital can be shown to correspond to a duty or obligation owed to a stakeholder group, it is material in the absolute sense

## 2. Relative Materiality

- All “Absolute” material impacts on vital capitals are not necessarily alike
- In MCS, we differentiate between them, accordingly



# Materiality in the MCS (cont.)

## 2. Relative Materiality (cont.)

- In the MCS, managers can relativize material impacts on capitals using standardized scales in three ways:
  - **Weight:** Managers can decide which impacts on vital capitals are most important and accord them more weight in performance measurement and reporting than others
  - **Progression:** All actual or current impacts are further qualified in terms of how they compare to sustainability norms or standards of performance
  - **Sizing:** The MCS allows users to adopt a mechanism for characterizing the scale of each impact so as to accurately reflect the impact's proportionate size relative to every other's; this is especially important in the case of consolidated reporting



# Duties and Obligations

# Duties and Obligations

- **Materiality in the MCS is grounded in the view that organizations have certain duties and obligations to manage their impacts on vital capitals so as to ensure stakeholder well-being**
  - Performance is all about impacts on vital capitals relative to what they would have to be in order to be sustainable (i.e., to be consistent with associated norms and standards)
- **It is up to each organization to (a) determine who its stakeholders are, and (b) identify duties and obligations it owes to them to manage its impacts on vital capitals, accordingly**
- **All such impacts should be expressed in terms of the carrying capacities of vital capitals**

# Duties and Obligations (cont.)

**Our use of the phrase “duties and obligations” is a very careful and intentional one and largely follows from the work of John Rawls and others as set forth in Rawls’ book, *A Theory of Justice* (1971). Both duties and obligations involve responsibilities owed by one party to another, but otherwise differ in some important ways. Starting with duties, Rawls explains them as follows:**

*“...there are many duties, positive and negative...The following are examples of natural duties: the duty of helping another when he is in need or jeopardy, provided that one can do so without excessive risk or loss to oneself; the duty not to harm or injure another; and the duty not to cause unnecessary suffering. The first of these duties, the duty of mutual aid, is a positive duty in that it is a duty to do something good for another; whereas the last two duties are negative in that they require us not to do something that is bad...Now in contrast with obligations, it is characteristic of natural duties that they apply to us without regard to our voluntary acts [i.e., without regard to, say, contracts we have entered into].”*

# Duties and Obligations (cont.)

**Turning next to obligations, Rawls explains them as follows:**

*“There are several characteristic features of obligations which distinguish them from other moral requirements [such as duties]. For one thing, they arise as a result of our voluntary acts; these acts may be the giving of express or tacit undertakings, such as promises and agreements, but they need not be, as in the case of accepting benefits. Further, the content of obligations is always defined by an institution or practice the rules of which specify what it is that one is required to do...As examples of institutions, or more generally social practices, we may think of games and rituals, trials and parliaments, markets and systems of property... And finally, obligations are normally owed to definite individuals, namely, those who are cooperating together to maintain the arrangement in question.”*

**It is the moral force of duties and obligations, then, for what an organization’s impacts on vital capitals must be that forms the basis of the MCS approach to making materiality determinations. Sustainability deals with obligatory acts, not discretionary ones!**



# **MCS Materiality Template with Examples**

# MCS Materiality Template with Examples

		Absolute Materiality				Relative Materiality			
		Sample Areas of Impact (AOI)	Corresponding D/Os Exist <sup>1</sup>	Associated Stakeholder Groups	Impacts are De Minimis (Y/N) <sup>2</sup>	Impacts are Material (Y/N)	Weight	Progression	Sizing
Social	Product Safety	Yes	Consumers	N/A	Yes	OS <sup>3</sup>	OS <sup>3</sup>	OS <sup>3</sup>	
	Charitable Giving	No	N/A	N/A	No	N/A	N/A	N/A	
Economic	Owners' Equity	Yes	Owners	N/A	Yes	OS <sup>3</sup>	OS <sup>3</sup>	OS <sup>3</sup>	
	Provision of Employment	No	N/A	N/A	No	N/A	N/A	N/A	
Environ.	Water Use at Plant A	Yes	Local Community	No	Yes	OS <sup>3</sup>	OS <sup>3</sup>	OS <sup>3</sup>	
	Water Use at Plant B	Yes	Local Community	Yes	No	N/A	N/A	N/A	

1. This column asks whether or not corresponding duties or obligations (D/Os) exist for each AOI, by which norms for impacts on vital capitals can be defined so as to maintain them at levels required to ensure stakeholder well-being.
2. Applies only to impacts on Natural Capitals, which unlike other capitals are finite in supply and cannot be increased at will.
3. Organization-specific (OS) assignments of values for these variables are made using MCS-recommended or custom scales.

# Notes on Sample AOs

- **Product Safety**

- *Duties & Obligations*: All companies have a duty or obligation to ensure that the products or services they provide are safe when used
- *Impacts are De Minimis*: This consideration only applies to impacts on Natural Capitals and is therefore not applicable to this particular area of impact
- *Impacts are Material*: Yes, because the impact corresponds to a duty or obligation owed by the organization to a stakeholder group to manage its impacts on vital capitals in a particular way

- **Charitable Giving**

- *Duties and Obligations*: All such giving is discretionary and therefore immaterial to sustainability reporting



# Notes on Sample AOs (cont.)

- **Owners' Equity**

- *Duties & Obligations*: All companies have a duty or obligation to provide a return on owners' equity
- *Impacts are De Minimis*: This consideration only applies to impacts on Natural Capitals and is therefore not applicable to this particular area of impact
- *Impacts are Material*: Yes, because the impact type corresponds to a duty or obligation owed by the organization to a stakeholder group to manage its impacts on vital capitals in a particular way

- **Provision of Employment**

- *Duties and Obligations*: Organizations are under no obligation to provide employment and so the jobs they provide are immaterial to sustainability performance

# Notes on Sample AOs (cont.)

- **Water Use at Plant A**

- *Duties & Obligations*: All companies have a duty or obligation to constrain their use of water resources so as not to deprive others of their own fair, just and proportionate shares
- *Impacts are De Minimis*: In the example we give, we assume actual impacts on water supplies at Plant A are not de minimis; this criterion applies in this case because water use constitutes an impact on Natural Capital
- *Impacts are Material*: Yes, because the impact corresponds to a duty or obligation owed by the organization to a stakeholder group to manage its impacts on vital capitals in a particular way, and the impacts already taking place are not de minimis

# Notes on Sample AOs (cont.)

- **Water Use at Plant B**

- *Duties & Obligations*: All companies have a duty or obligation to constrain their use of water resources so as not to deprive others of their own fair, just and proportionate shares
- *Impacts are De Minimis*: In the example we give, we assume actual impacts on water use at Plant B are, in fact, de minimis; this criterion applies in this case because water use constitutes an impact on Natural Capital
- *Impacts are Material*: No, because even though the impact corresponds to a duty or obligation owed by the organization to a stakeholder group to manage its impacts on vital capitals in a particular way, the impacts involved are de minimis

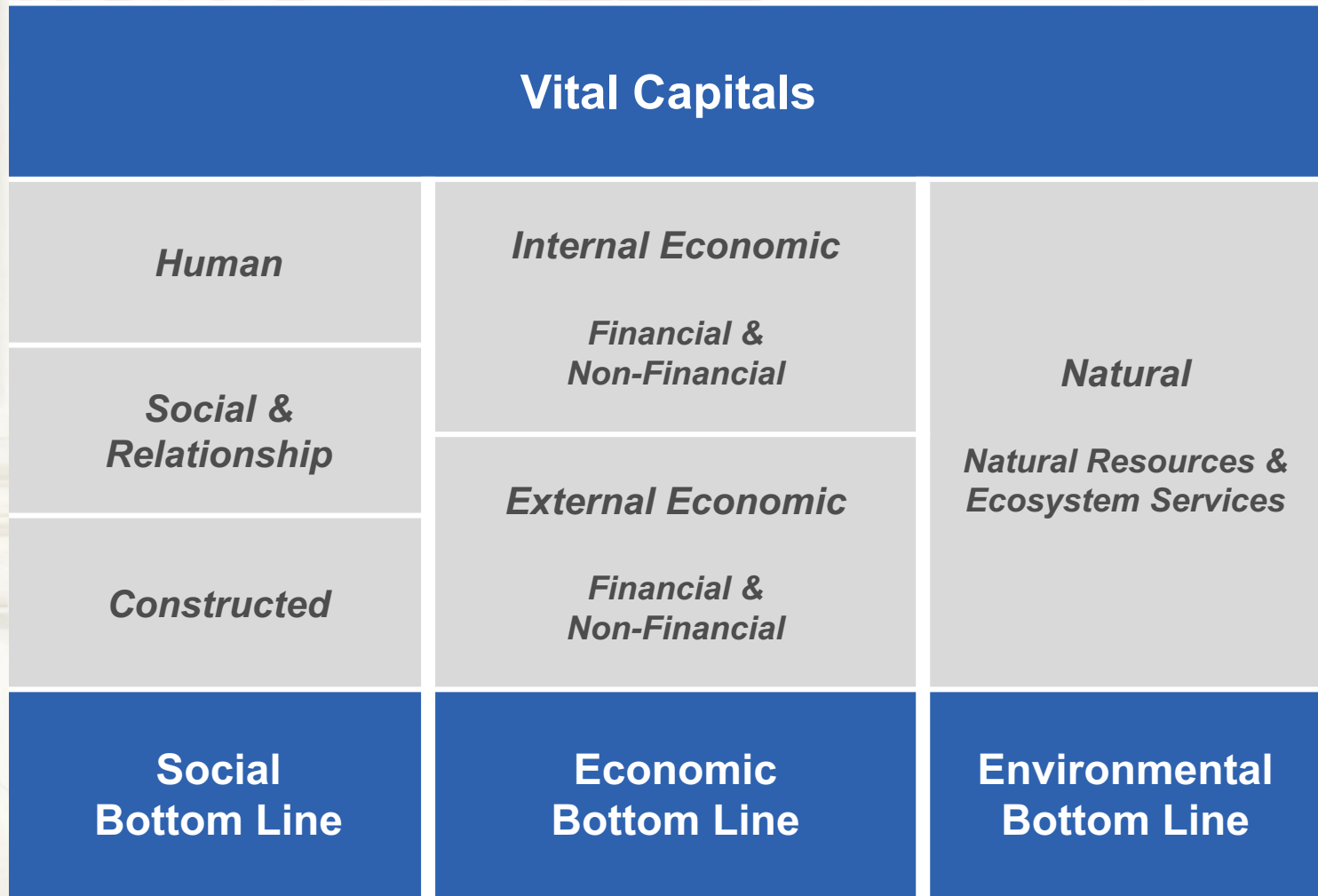
# How We Define De Minimis

- **An impact that is otherwise material in the Absolute sense can be treated as immaterial if the impacts involved are de minimis**
- **We define de minimis in terms of an impact's effects on the carrying capacity of a vital Natural Capital, if and when generalized**
  - First we determine what the extent of the impact is
  - Then we generalize it to a contextually relevant population as if everyone involved were having the same impact
  - Then we compare the generalized impact to the carrying capacity of the capital involved (e.g., to the volume of renewable water in a watershed)
  - If the generalized impact is extremely low (e.g., <5%), the organization's own impact is considered de minimis



# **Appendix:**

## **Definitions of Vital Capitals**



## **Vital Capitals and the Triple Bottom Line**

(see capital definitions on the slides that follow)

# Definitions of Vital Capitals

## Natural Capital

### - Natural Resources

Consists of air, land, water, minerals, flora, fauna, ecosystems and other natural material resources that humans and non-humans alike rely on for their well-being.

### - Ecosystem Services

Consists of services or functions provided by ecosystems that humans and non-humans alike rely on for their well-being. Examples include climate regulation.

## Human Capital

Consists of knowledge, skills, experience, health, values, attitudes, motivation and ethical entitlements of individuals. This therefore includes the intellectual capital held at the level of the individual.

# Definitions of Vital Capitals (cont.)

## Social & Relationship

Consists of teams, networks and groups of individuals working together. It includes their shared knowledge, skills, experience, health, values, attitudes, motivation and ethical entitlements. This therefore includes the shared intellectual capital of the group. Groups may be wholly internal to an organization, external to an organization, or inter-organizational, and may or may not be controlled by the organization of interest. They may be physical groups, virtual groups or blends of both.

## Constructed Capital

Consists of material objects, systems or ecosystems created and/or cultivated by humans, including the functions they perform. It is the world of human artifacts and the functions or services they provide, in which other capitals will usually be embedded, although in modified or designed forms. It is the world of human design.



# Definitions of Vital Capitals (cont.)

## Internal Economic Capital

### *- Financial*

Consists of the pool of funds available to an organization, including debt and equity finance. This description of financial capital focuses on the source of funding (liabilities on the balance sheet) rather than its application, which usually results in the acquisition of assets such as land, buildings, plant and inventories or other forms of capital (e.g., intellectual property).

### *- Non-Financial*

Consists of net assets not recognized in internal financial capital. This category captures assets pertaining to an organization that are not recognized as financial capital. They may or may not also be monetized and reflected in the *Financial* category. An example is the value of brands that have been developed organically internally, but not recognized in the financial accounts.

# Definitions of Vital Capitals (cont.)

## External Economic Capital

### *- Financial*

Consists of all financial funds available to parties outside an organization. MCS takes account of the impact an organization has (or should have) on the financial capital of entities other than the reporting entity itself. For example, an investment in a factory, outlet or warehouse may reduce the financial value of other owners' properties in the vicinity. Impacts, too, may impose costs on society, such as the healthcare or municipal costs of dealing with an adverse impact on the environment.

### *- Non-Financial*

Consists of externally held capitals of a non-financial nature, which nevertheless have economic value to others.

# Contact Information

For more information about the MultiCapital Scorecard, including opportunities to pilot the method in your own organization, feel free to contact us at the following coordinates:

## In the UK:

Martin Thomas  
Thomas & McElroy LLC  
Green Lane House, The Mount  
Guildford  
KT22 9AZ  
Surrey, UK  
PHONE: +44 (0) 01483 808105  
MOBILE: +44 (0) 7899 064 956  
EMAIL: [martin@call4change.com](mailto:martin@call4change.com)  
Skype: martinthomas

## In the US:

Mark McElroy  
Thomas & McElroy LLC  
P.O. Box 766  
Woodstock, VT 05091, USA  
PHONE: 1 (802) 457-4222  
MOBILE: 1 (802) 296-1928  
EMAIL: [mmcelroy@vermontel.net](mailto:mmcelroy@vermontel.net)  
Skype: mwmcelroy  
Twitter: @mwmce

Click here for an [Overview of the MCS](#)  
Click here for a [Prospectus on Piloting the MCS](#)

[www.multicapitalscorecard.com](http://www.multicapitalscorecard.com)