

**Title: Comments on the discussion paper
TOWARDS INTEGRATED REPORTING - Communicating Value in the 21st Century**

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Dear Editors of International Integrated Reporting Committee (IIRC),

Arbeitskreis Wissensbilanz (AKWB) is a research group that promotes the scientific development and broad application of Intellectual Capital Statements as a strategic management tool. We help organisations to understand, collect, evaluate and develop their Intellectual Capital systematically. Our ultimate ambition is to strengthen innovation potentials and sustainable competitiveness of the knowledge based economy. Therefore, we welcome and support your initiative of an integrated reporting framework and respond to the open invitation to comment the discussion paper and would like to address the following issues:

Developments to Date:

There are many initiatives, nationally and internationally, already working on improvement of transparency and thus contribute to better management as well as lower transaction costs. Given the experiences over a timeframe of more than 15 years (starting with a series of publications in 1996) and strong support by SMEs (more than 1000 applications in Germany alone), **we suggest to include “Intellectual Capital Reporting”** in the text and illustration of page 7 on “evolution of corporate reporting”. The term “Intellectual Capital” is already established (page 11), but given the growing importance of “the knowledge society”, a distinguished approach might deserve consideration.

The following research groups are focusing on ICR and offer a comprehensive framework:

- German working Group on Intellectual Capital Statements (www.akwissensbilanz.org), supported by the German Ministry of Economics and Technology.
- Intellectual Capital Statement Made in Europe (www.incas-europe.org), supported by the European Commission – FP6
- Ricardis (http://ec.europa.eu/invest-in-research/policy/capital_report_en.htm) supported by the European Commission.

The following publications are suggested as reference covering the most relevant issues:

http://www.akwissensbilanz.org/Infoservice/Infomaterial/Leitfaden_english.pdf

http://www.psych.lse.ac.uk/incas/page114/files/page114_1.pdf

Fraunhofer IPK published a tested a methodology to **audit Intellectual Capital Reports** and thus contribute to improve the reliability and validity of such report.

Examples:

A candidate for best practice in integrated reporting is **EnBW AG**, a major energy supplier from Germany, who publishes the status quo of **Intellectual Capital** for already **6 years**. They have an excellent track record of **time series** that show the successful management of Intellectual Capital with differentiated categories of Human Capital , Structural Capital and Relational

Capital and integrates the data on appropriate sections in the “review of the economic situation” (Lagebericht). The continuous reporting of EnBW AG therefore credibly supports their dedication to **create transparency** on essential drivers for strategic performance from several stakeholders’ perspectives and **presents the data in an integrated form within their annual report** (see Figure 1).

Development of the factors influencing the intellectual capital of EnBW

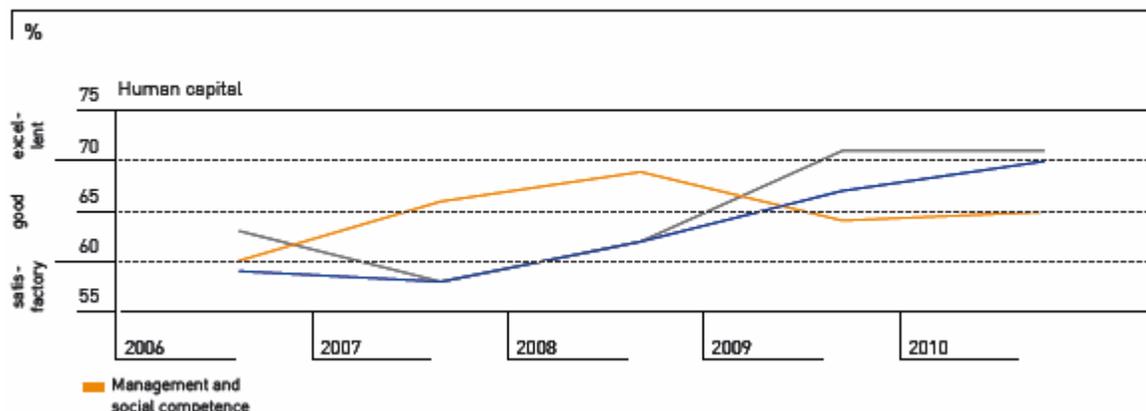


Figure 1: <http://annualreport.enbw.com/2010/management-report/employees/human-capital.html?subjects=2|3|&subjectp=4p>

All the content elements (page 14f) are supported, but particularly “**performance against objectives**” is a strength of the EnBW reporting.

Impact of Intellectual Capital Reports:

The impact of Intellectual Capital Reporting on Financial Markets as a group of stakeholders was tested and confirmed by the AKWB research reports "Does Intellectual Capital Reporting Matter to Financial Analysts?" and “Wissensstandort Deutschland”. The first report shows that Intellectual Capital Reporting contributes to reducing information asymmetries between the management of companies and financial market. Therefore it contributes to a more homogeneous rating and reduces risks of investment.

The second report shows the importance of Intellectual Capital for the decision making process of management as well as owners.

References:

- Kay Alwert, Manfred Bornemann, Markus Will: **Does Intellectual Capital Reporting Matter to Financial Analysts?** Journal for Intellectual Capital. 2009, Emerald Group Publishing Limited ISSN 1469-1930.
- Bundesministerium für Wirtschaft und Technologie (BMWi): „**Studie Wissensstandort Deutschland**“ http://www.akwissensbilanz.org/Infoservice/Infomaterial/Studie_Wissensstandort_Deutschland.pdf Berlin, 2010.
- Bundesministerium für Wirtschaft und Technologie (BMWi): **Intellectual Capital Statement Guideline 1.0**; Berlin, 2004 http://www.akwissensbilanz.org/Infoservice/Infomaterial/Leitfaden_english.pdf
- InCaS - **Intellectual Capital Statement for Europe**; Brussels 2010 http://www.psych.lse.ac.uk/incas/page114/files/page114_1.pdf

Position to the Questionnaire:

Q1. (a) Do you believe that action is needed to help improve how organizations represent their value-creation process? Why/why not?

Particularistic actions typically fail to support comprehensive targets. Integrated representation should be the result of integrated management which in turn is more likely to generate long term development than mono-causal effort.

(b) Do you agree that this action should be international in scope? Why/why not?

An International scope allows consideration of different approaches and perspectives. As a consequence, complexity rises and consensus is typically harder to formulate. However, the long term benefit of aligning international efforts avoids parallel structures or non-compatible approaches which is beneficial to most players. Our experience from recent activities (e.g. InCaS – Intellectual Capital Statements - Made in Europe) shows that an international perspective is useful to develop a seminal and commonly agreed consensus.

Q2. Do you agree with the above definition of Integrated Reporting? Why/why not?

Basically we agree with the proposed definition. Especially the statement “[IR...] shows the connectivity between them” seems important to us. Anyway we propose to put more emphasis on the relevance on intangible resources, the so called “Intellectual Capital” within this definition.

Q3. Do you support the development of an International Integrated Reporting Framework? Why/why not?

Yes we do – see above Q1 (b). An international working group should include stakeholders from different sectors and disciplines to cover all relevant aspects and interests. An international integrated reporting framework could - after reasonable time for discussion and tests - come up with a powerful concept.

Q4. (a) Do you agree that the initial focus of Integrated Reporting should be on reporting by larger companies and on the needs of their investors? Why/why not?

Large companies are often pioneers in such initiatives, e.g. due to higher demands of relevant stakeholders. Anyway we think that small and medium enterprises (SMEs) should be considered from the beginning on because our experience shows that a “simple downsizing” (from large to small and medium enterprises) in the end is difficult. And it should be considered that SMEs account for over 95% of firms and up to 70% of employment in OECD economies. Maybe one of the three IIRC task forces can tackle this issue parallel to the main activities focused on larger companies.

(b) Do you agree that the concepts underlying Integrated Reporting will be equally applicable to small and medium enterprises, the public sector and not-for-profit organizations?

Regarding the implementation of Intellectual Capital Reports we have a broad experience in SME, the public sector and not-for-profit organizations. Our experience shows that the concept is basically applicable to these types of organizations but some adjustments (e.g. detailed definitions of capital factors and indicators) are necessary. Given the requirements of scalability and scope as well as preventing excessive costs in relation to benefit on a voluntary basis, IR could add value to management activities of SMEs as well as not-for-profit organizations.

Q5. Are: (a) the organization’s business model, and (b) its ability to create and sustain value in the short, medium and long term, appropriate as central themes for the future direction of reporting? Why/why not?

Yes, because financial statements are not appropriate for this purpose as they are mostly short term-oriented and one-sided. On the other hand, prevailing approaches of CSR reports are often disconnected from business (cf. Porter 2006). Therefore an integrated reporting scheme, considering the organization’s business model and value creation activities in the short, medium and long term seems to be advisable. Against this background, especially the consideration of intangible resources seems to be promising

because this Intellectual Capital is one of the most important value drivers for future success of almost any organization.

Q6. Do you find the concept of multiple capitals helpful in explaining how an organization creates and sustains value? Why/why not?

Yes. The concept of multiple capitals is very useful and a step ahead from the classical triple bottom line concept. But as already mentioned above, we propose more emphasis on intangible resources. In this context we classify Intellectual Capital (IC) into three categories: Human Capital, Structural Capital and Relational Capital: Human Capital refers to the staff's competencies, attitudes and skills. It is owned by and remains with the employee and can be taken to the next employer. Structural Capital comprises all structures and processes needed by the employee in order to be productive and innovative. It "consists of those intangible structures which remain with the organisation when the employee leaves" (Edvinsson, Malone 1997). Relational Capital sums up the organisation's relations to its stakeholders. Intellectual Capital in general follow a different economic logic than goods and capital and thus benefit from distinct reporting.

Q7. Do the Guiding Principles identified in the Discussion Paper provide a sound foundation for preparing an Integrated Report – are they collectively appropriate; is each individually appropriate; and are there other Guiding Principles that should be added? Why/why not?

The guiding principles are fine. Are there already any recommendations regarding the principle of "Connectivity of information"? This point is often/sometimes a lack in company reporting (cf. Clausen et al. 2006 on the disclosure of sustainability information of European companies).

In the past we made good experience by using Frederick Vester's "Cross Impact Matrix" to show causal relationships between different elements of similar models / approaches.

Q8. Do the Content Elements identified in the Discussion Paper provide a sound foundation for preparing an Integrated Report – are they collectively appropriate; is each individually appropriate; and are there other Content Elements that should be added? Why/why not?

Dealing with the proposed content elements will not only provide a sound base for reporting – it will also help decision makers for internal management purposes.

Q9. From your perspective as a reporting organization:

(a) Do you agree with the main benefits as presented in the Discussion Paper? Why/why not?

(b) Do you agree with the main challenges as presented in the Discussion Paper? Why/why not?
not applicable

Q9. From your perspective as an investor:

(a) Do you agree with the main benefits as presented in the Discussion Paper? Why/why not?

(b) Do you agree with the main challenges as presented in the Discussion Paper? Why/why not?

(c) Do you agree that Integrated Reporting will drive the disclosure of information that is useful for integrated analysis? Why/why not?

not applicable

Q9. From your perspective as a policy-maker, regulator or standard-setter:

(a) Do you agree with the main benefits as presented in the Discussion Paper? Why/why not?

(b) Do you agree with the main challenges as presented in the Discussion Paper? Why/why not?
not applicable

Q9. From your perspective as a key stakeholder:

(a) Do you agree with the main benefits as presented in the Discussion Paper? Why/why not?

Academics / Research: Integrated Reporting evolves over time and provides an opportunity to harmonize and integrate different research disciplines and approaches. The development of the initial Framework will foster this process and vice versa.

(b) Do you agree with the main challenges as presented in the Discussion Paper? Why/why not?

For companies integrated reporting on sustainable value creation in the 21st century is an important topic. Anyway it is necessary to bridge the gap between (external) reporting and internal management. But we think that the proposed IIRC framework provides the basis for doing so.

Q10. (a) Do you agree that the actions listed in the Discussion Paper should be the next steps undertaken by the IIRC? Why/why not? Are there other significant actions that should be added?

Regarding the planned actions we especially support the developing of the Exposure Draft of the Framework and working with others on emerging measurement and reporting practices; especially the consideration about reporting Intellectual Capital / intangible resources.

(b) What priority should be afforded to each action? Why?

Q11. Do you have any other comments that you would like the IIRC to consider?

We would be delighted to participate in the further activities of the IIRC (knowledge exchange, etc.).