W I C I
Global WICI Network

the world's business reporting network
www.wici-global.com

30 April 2017

RE: "World Intellectual Capital/Assets Initiative" (WICI) Global Network – Response to the invitation to comment issued by the International Integrated Reporting Council (IIRC) on the <IR> Framework Implementation

Dear International Integrated Reporting Council (IIRC),

The "World Intellectual Capital/Assets Initiative" (WICI) Network (www.wici-global.com) is a global, non-profit organization founded in 2007 by relevant private and public sector organizations in Europe, the U.S. and Japan. It aims at establishing a comprehensive business reporting framework that enables corporate management to express company's own way of using intellectual/intangible assets and other non-financial elements for the purpose of creating value, by also pointing out how the past, present and future performances connect to non-financial elements.

In particular, since a few years WICI has been committed to the building and refinement of an overall business reporting framework combining financial and non-financial information, as well as to the elaboration of industry-specific Key Performance Indicators (KPIs) for explaining company value creation (www.wici-global.com/kpis).

In this sense, in September 2016 WICI has published an "*Intangibles Reporting Framework*" to provide relevant definitions, principles, and contents to companies and other organizations to report on their intangible resources outside the financial statements in a value creation perspective (http://www.wici-global.com/wp-content/uploads/2016/09/WICI-Intangibles-Reporting-Framework_ver-1.0.pdf). Our Framework is aligned with the International <IR> Framework.

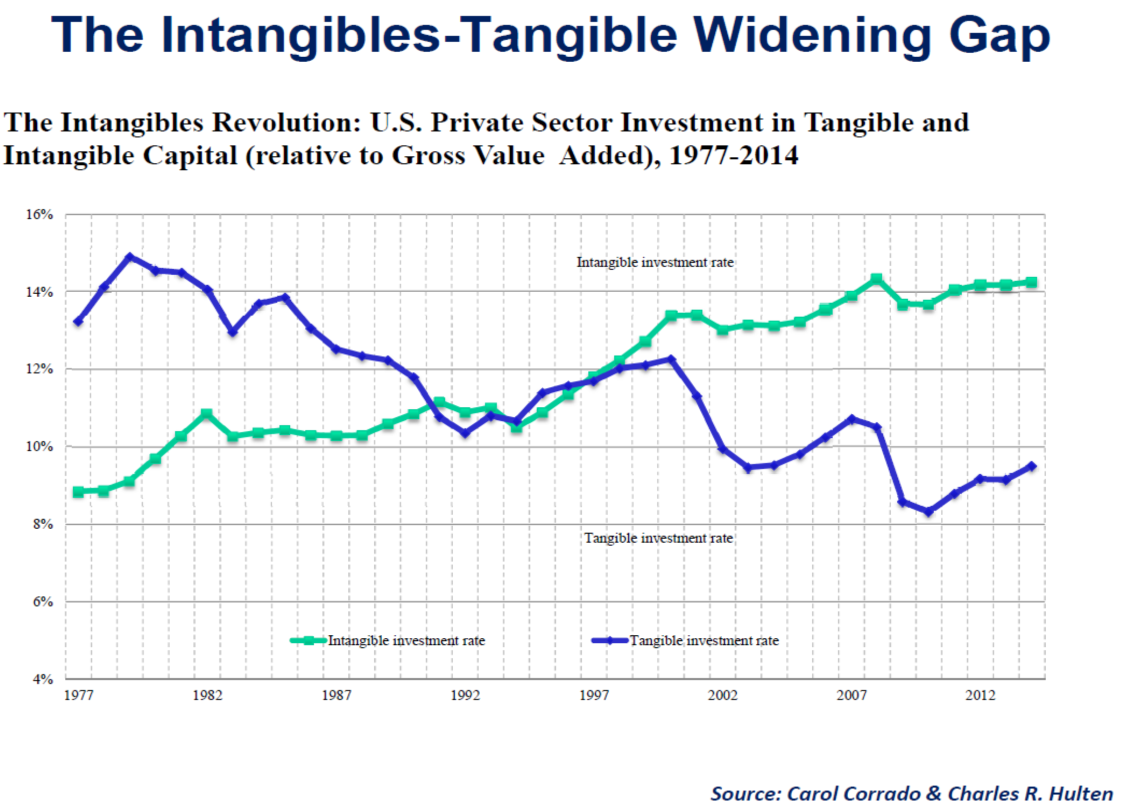
WICI intends to play a role internationally in fostering a new business reporting culture which is more oriented to a better measurement and transparency of firm events and resources (especially the intangible ones), and an improved communication between the firm and its stakeholders (investors in particular).

WICI would like to take this opportunity to respectfully submit its comments and suggestions to the IIRC. In the following, you will find first some general observations regarding fundamental concepts of <IR>, and then detailed answers to some specific questions proposed in your invitation to comment.

<u>Issues with Fundamental Concepts</u>

- Explicit Recognition of the role of Intangibles and Knowledge for value creation

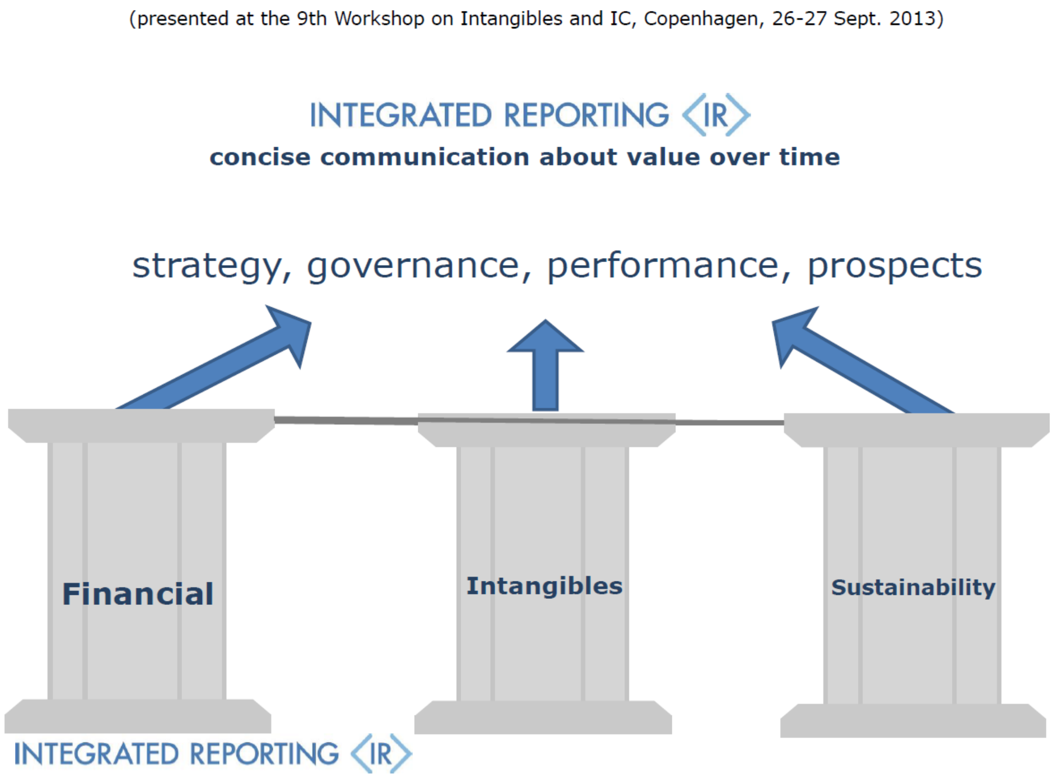
We all know – and hopefully share – the importance of intangible resources and knowledge for today's value creation of any organization. Evidence from the academic literature is overwhelming in this respect, as well as the results of OECD, European Commission and METI studies over the years. The following diagram can be helpful to depict the current situation in the USA, which is similar to other major industrialized countries.



Furthermore, the U.S. Financial Accounting Standards Board (FASB) has recently put the topic of Intangibles reporting back on its working agenda.

It is therefore noteworthy that at the moment in the <IR> Framework there is only three mentions each of the word “intangibles” and the word “knowledge”. To be true, the word “intangible” appears three times at p. 12 (“Intellectual capital – Organizational, knowledge-based intangibles” and “Social and relationship capital includes…. intangibles associated with the brand and reputation that an organization has developed”, and in passing in para. 2.18). The term “knowledge” is used twice at p. 12 and one at p. 13.

In a public speech delivered in September 2013 at a European academic event, Mr. Paul Druckman, then IIRC CEO, was defining the conceptually foundational pillars of the <IR> as follows:



Source: Paul Druckman, IIRC, Speech at the Copenhagen Business School, September 2013

Accordingly, we suggest that the revised version of the Framework could include an (initial) section where the crucial role of intangibles and knowledge can be explicitly recognized along with that of sustainability aspects.

- ***Definition of «non-financial»***

Also in light of the publication of the European Directive no. 95/2014, we feel it would be very useful whether IIRC could take a clear position on the term “non-financial” and add it in the glossary of the <IR> Framework. As is well known, the Directive essentially conceives as "non-financial" the ESG information.

However, from a conceptual standpoint we think that the term "non-financial" is much broader and that the information and metrics included in an <IR> have largely a "non-financial" nature.

In this respect, we would like to propose for consideration to the IIRC Framework Revision Panel the definition of "non-financial" provided by the "*WICI Intangibles Reporting Framework*" (p. 43):

"The term "non-financial" is utilized …to refer to narrative or quantified information that is not expressed in monetary units (e.g., percentage, Likert scale, absolute number, physical measures). Non-financial' does not mean that a measure or information does not have a financial impact or significance. Sometimes the expressions "non-monetary", "extra-financial", "pre-financial" or "not yet financial" are used synonymously with "non-financial"."

Would this definition be acceptable to the IIRC for its revised <IR> Framework?

- *Concept of value*

In the <IR> Framework the concept of value is not clear and is very vague. It seems to be understood as deriving from variations of the considered capitals, and this would imply the use of stock measures to describe how capitals change over time.

According to the "*WICI Intangibles Reporting Framework*", the concept of value is split in two interconnected notions: "Financial Value" and "Strategic Value". By "Strategic Value" is meant "Value related to the enhancement of the competitive, market, product, reputation, and/or risk profile of the organization", while "Financial Value" is defined as "Value linked to the generation of net cash flows over time"

Would the above definitions of value be acceptable to IIRC for its revised <IR> Framework?

- Concept of "capital"

In the <IR> Framework it is not clear whether the resources which substantiate the various forms of capitals should be *owned, controlled or simply available for use*. This clarification appears to be crucial for the <IR> intangibles-based capitals, such as human capital, relationship and social capital and the intellectual/organizational capital, as well as for the natural capital.

Indeed, it seems rather evident that the concept of capital cannot be the same as that, for example, of IASB's Conceptual Framework, where an asset is a resource *controlled* by an entity as a result of past events.

In the case of <IR>, it appears to us that resources to be considered should be *available for use to the entity and participating in its value creation processes*, and not necessarily owned or controlled by the entity.

In the "*WICI Intangibles Reporting Framework*" we expressed this critical concept in the following way (pp. 13-14):

"Intangibles are resources that are *available for use* by an organization. Sometimes, they are actively managed in a fully conscious way, but other times they exist or are utilized beyond, or with a limited amount of awareness by, the organization (e.g., reputation). Unlike assets as defined in financial accounting (e.g., under the IASB Conceptual Framework for Financial Reporting), it is not necessary that intangibles are owned or controlled by an organization. They simply have to be available and/or utilized by the entity with the aim of generating value."

Responses to specific questions

Q1a: What is your experience with the multiple capitals approach in integrated reports?
More accurate and less vague definitions for Capitals could be useful to classify company resources and values. Indeed, it could be useful to be clearer with regard to the definitions of capitals. In particular, this is true for the definition of Intellectual Capital. It would be beneficial and conceptually consistent to align the definition of Intellectual Capital to that largely prevailing in the literature («Journal of Intellectual Capital», «Journal of Knowledge Management»).
At the moment the expression «Intellectual Capital» is used in the <IR> Framework in different ways and referring to different resources (cf. para. 2.15 and para. 2.18). We propose to use the term «Organizational Capital» to signify what is now defined as «Intellectual Capital» in order to avoid confusion and to be more consistent with the 20-year strong specialized literature on the topic.

Q4a: What is your experience with the Framework's definition of materiality, in particular:
• Application of the value creation lens?
• Use of different time periods to identify material matters?

To introduce and put emphasis on the notion of different time periods in order to identify material matters is quite relevant. WICI believes that material elements for a company's value creation may be different in the future from those in the past, due to the change in the business circumstances or prospects of it and in the company's decision to change its strategy for creating values based on future business circumstance. This is also clearly defined in the "*WICI Intangibles Reporting Framework*".

Q8a: What is your experience with the application of these remaining three Guiding Principles (Strategic focus and future orientation; Reliability and completeness; Consistency and comparability) in integrated reports?

The residual nature of this question seems to imply that IIRC may put some priority on other four guiding principles (Connectivity of information; Stakeholder relationships; Materiality; Conciseness). This attitude of seemingly putting priority on some principles is quite a relevant aspect. Amongst the three principles here in question, WICI believes that future orientation and comparability are also very relevant.

The importance of future orientation is related to answer Q4a. Namely, material elements and value creation mechanism may change in the future, so investors and stakeholders have certainly a strong interest in knowing as soon as possible the new future value creation mechanism of the company and its relevance.

Comparability is another important principle especially in the description of intangibles-related capitals, including intellectual/organizational capital, human capital and relationship capital, since the notion of comparability linked to these capitals is quite different from that prevailing in respect to financial capital. More details can be found in the "*WICI Intangibles Reporting Framework*".

Q11a: What is your experience with enablers, incentives or barriers to Framework implementation not covered by other questions, including the extent to which they apply particularly to: • Specific jurisdictions? • Large or small organizations? • Private, public or non-profit sectors? • Different stages of Framework implementation?

There was a barrier for companies to implement <IR> Framework especially on *intangibles*, namely organizational capital, relationship capital and human capital, on whose reporting there was no clear guidance issued by any other international organization. Therefore, WICI issued in September 2016 a new Framework document titled "*WICI Intangibles Reporting Framework*" which can be fruitfully used for companies to prepare Integrated Reporting. WICI strongly advises IIRC to point to and encourage companies to utilize this new, companion Framework when they prepare their IR.

Moreover, another two issues regard **KPIs**.

There is no definition in the <IR> Framework of what is exactly a KPI. It would be useful whether IIRC could provide a definition of what exactly is a KPI in its view. We permit ourselves to suggest for IIRC's consideration the definition of KPI that WICI has recently laid down in its "*Intangibles Reporting Framework*": "KPIs are numerical figures (metrics) related to critical/material factors of value creation and which should provide objective evidence of performance trends by tracking them over time" (p. 20).

A second issue relating to KPIs is the recognition that the availability of industry KPIs orientated to measure capitals in the perspective of value creation, would facilitate entities to embrace <IR> and help *comparability*, which is one of the fundamental <IR> principles. This is also recognized by para. 3.57 of the <IR> Framework. However, many of the KPIs provided by international organizations have an ESG orientation. For several industries, a possible useful reference to KPIs, which are consistent with the <IR> Framework philosophy, is that to the WICI-KPIs (www.wici-global.com/kpis) because they are centered on the value creation processes that are typical of a sector.

Sincerely yours,

Prof. Stefano Zambon (PhD)
WICI Global Chair