

„The German Experience in IC-Reporting“

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Gefördert durch:



Bundesministerium
für Wirtschaft
und Technologie

aufgrund eines Beschlusses
des Deutschen Bundestages



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1. ***Regulation for intangibles within financial accounting in Germany***
2. ***Wissensbilanz (Intellectual Capital Statement, ICS) – made in Germany***
3. ***ICS as part of the Management Commentary***
4. ***ICS as part of the Performance Management Systems (PMS)***
5. ***Conclusion***

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1. Regulation for intangibles within financial accounting in Germany

Recognition of Intangibles within financial accounting

- Internally generated intangible assets are allowed to recognize within balance sheet if the recognition criteria are met (Choice for recognition acc. § 248 Par. 1 German Commercial Code).
 - Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance shall not be recognized as intangible assets.
 - The importance of intangible resources for companies' success has increased (e. g. know-how of employees, customer relations). But, lots of these resources are not recognized as an asset → high amount of goodwill within business combinations
-
- Implicitly, the owners' equity is the lower the more investments are made in internally generated intangible assets (Edvinsson, Malone, 1997).
 - Thus, the investment character of intangibles disappears .

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1. Regulation for intangibles within financial accounting in Germany

Financial reporting according to German GAAP

Financial Reporting standardized by accounting rules

- Balance Sheet
- Profit and Loss Statement
- Notes
- Segment Reporting
- Statement of Cash Flow

Management
Commentary*
(explained within GAS
15**)

Voluntary reporting,
not standardised by
accounting rules

* Not obligatory for small sized companies (§ 264.1 German GAAP)

** GAS: German Accounting Standard

Value Reporting

Obligatory information within Management Commentary referring to Value Reporting:

- Analysis of the business performance considering non-financial indicators
- Future development of the company with its key resources and risks

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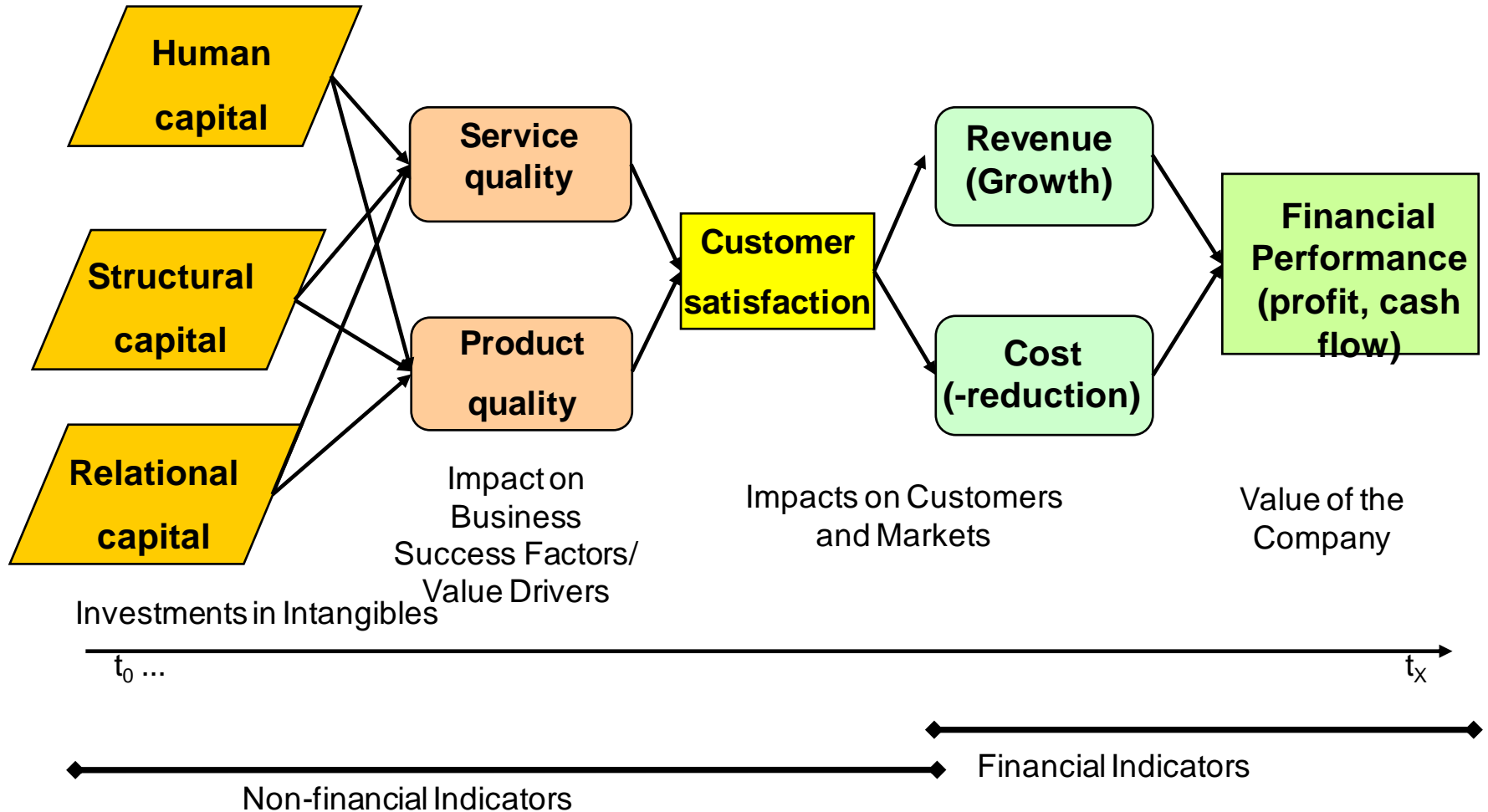


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1. Regulation for intangibles within financial accounting in Germany

Importance of IA-Reporting within accounting The Process of Sustainable Value Creation (Example)



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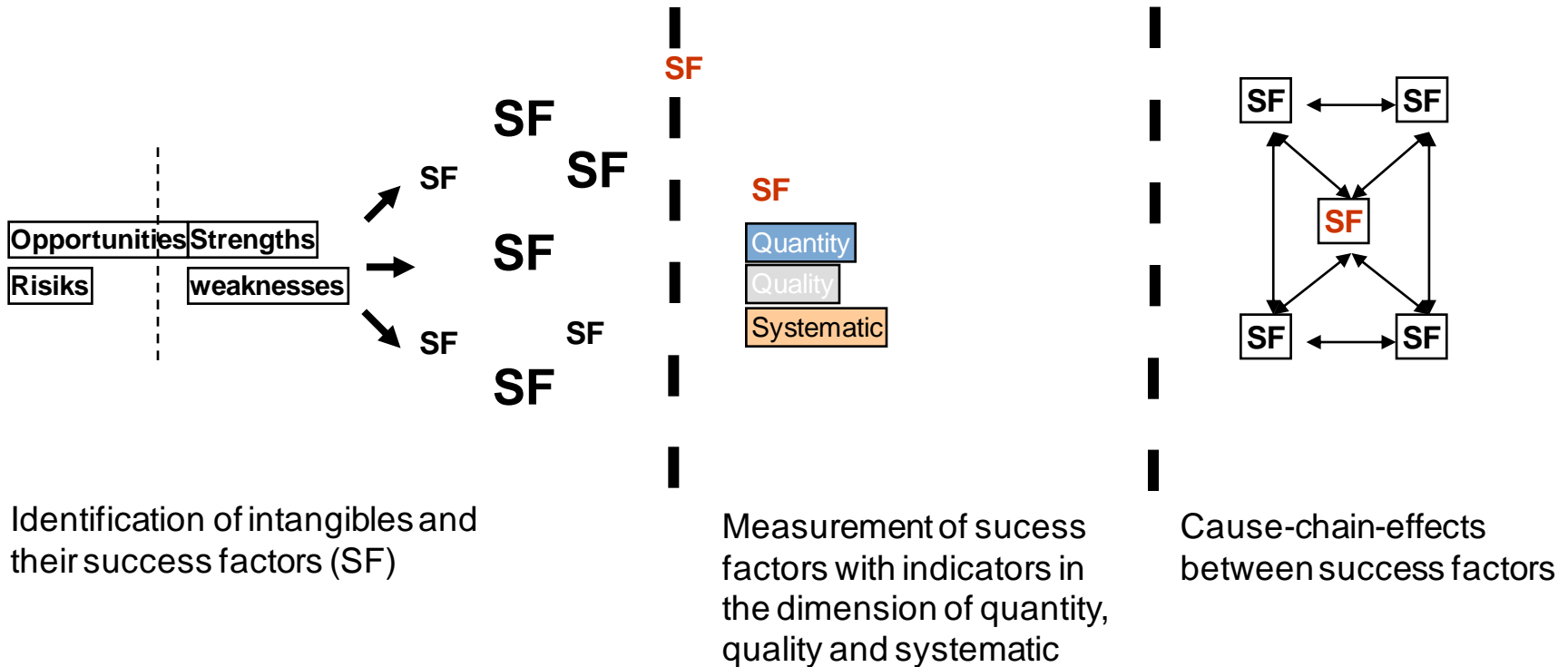
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2. Wissensbilanz (Intellectual Capital Statement, ICS) – made in Germany

Wissensbilanz (ICS) – made in Germany

Steps for identification and measurement of intangibles



Identification of intangibles and their success factors (SF)

Measurement of success factors with indicators in the dimension of quantity, quality and systematic

Cause-chain-effects between success factors

Quantity: Do we have enough to reach our goals?

Quality: Are we doing the right and how are we doing this?

Systematic: Are we doing our task systematically?

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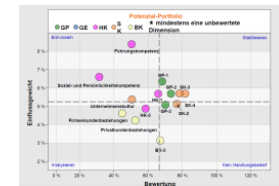
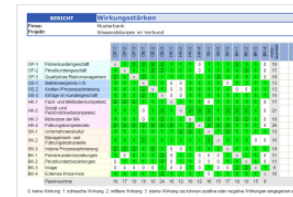
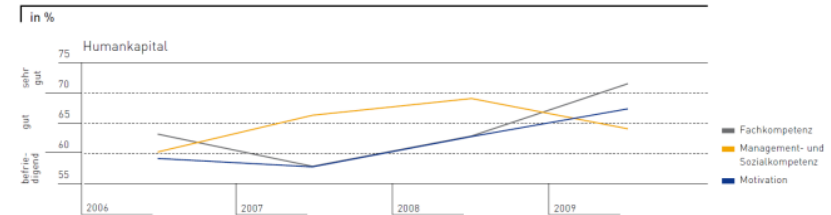
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2. Wissensbilanz (Intellectual Capital Statement, ICS) – made in Germany

Information presented within IC Statement

- Success factors:
 - definitions
 - measurement within the dimensions: quantity, quality and systematic (QQS-Measurement as a table)
 - QQS-measurement (diagramm)
 - Portfolio of potentials
 - cause-chain-effect-matrix
- Indicators
 - definitions
 - measurement for the current year and former years
- Management Actions



INDIKATOREN	Ist-Situation	Bewertung	Ziel in 2 Jahren
Humankapital: Identifikation mit dem Unternehmen			
Anzahl Krankheitstage p.a. (durchschnittl. Anzahl Tage)	9,5	~	↓ 7,5
Rücklauf der Mitarbeiterbefragung p.a.	85 %	+	
Anteil der Mitarbeiter, die sich lt. Mitarbeiterbefragung mit den Werten und Zielen identifizieren	60 %	~	↑ 80 %
Weiterbildungskosten pro Kopf p.a.	280 €		↑ 350 €
Anzahl Weiterbildungstage pro Mitarbeiter p.a.	0,5	+	↑ 1
Humankapital: Führungskompetenzen			
Erfüllungsgrad der neuen Zielvereinbarungen p.a.	-		↑
Teilnahmequote an Führungsseminaren p.a.	-		↑
Anzahl der durchgeführten zukunftsgerichteten Mitarbeitergespräche p.a.	40	~	↑ 180
Durchschnittl. Anzahl von durchgeführten Jour-fixe-Veranstaltungen pro Führungskraft p.a.	14	~	↑ 45

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2. Wissensbilanz (Intellectual Capital Statement, ICS) – made in Germany

Expressiveness of ICS

- **A differentiated insight into the actual state of a company** is shown due to the consideration of employee groups that are representative in terms of the professions and hierarchies of their members.
- **An expressive information basis** is given about the strengths and weaknesses of a company.
- Recommendations for actions can be derived which are **steered by indicators**.
- **Often named points of criticism:**
 - in direction a **subjective measurement** of the success indicators.
Hence, the first ICS has to be understood as the first diagnosis of the actual state. Only within comparison over time the measurement is relativized, especially by the use of indicators.
 - **Neglect of a linkage to financial data** of a company.

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2. Wissensbilanz (Intellectual Capital Statement, ICS) – made in Germany

Utilization of ICS

Linkage of the ICS-results to

- external reporting of a company as an instrument for information and
- management information systems as an instrument for management.

Internal Reporting

- Strategic management
- Operative management

External Reporting

- Information for external interested parties, e.g. credit institutions, customers, employees

Convergence of internal and external accounting/reporting

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3. ICS as part of the Management Commentary

3.1 Legal requirements for Management Commentary

3.2 Proposal for reporting about intangibles within Management Commentary

3.3 Result from a survey referring to the Management Commentary

3.4 Case: EnBW (a main German energy provider)

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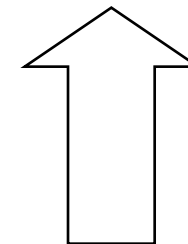
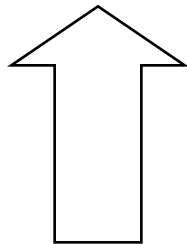
3. ICS as part of the Management Commentary

(BMW's project 2010-2012)

Balance Sheet, Income Statement

Management Commentary

- Defining interfaces
- Prepare a structured, verifiable and auditable reporting structure
- Transformation in a XBRL-format



Wissensbilanz (ICS)

Relational Capital

Human Capital

Structural Capital

Sucess factors

Cause-chain effects

Indicators

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3. ICS as part of the Management Commentary

3.1 Legal requirements for Management Commentary

Information that has to be reported:

- Description and analysis of the business activities within the reporting year
- Description and analysis of the financial position and performance including information about intangible assets
- Consideration and explanation of financial and non-financial indicators

Information that shall be reported:

- Research and development report

Voluntary information:

- Intellectual Capital Statement
- Success factors and indicators about different categories of intangibles not recognised within balance sheet

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3.2 Proposal for reporting about intangibles within Management Commentary

German Commercial Code/GAS versus IC-Statements

1. Importance of intangibles for the company and the strategy

German Commercial Code/GAS	IC-Statement
	Strategy with approach to intangibles
Details about intangibles	Importance of the success factors of intangibles
Classification of intangibles into different categories	Different categories of intangibles
Past-oriented information up to the reporting date	
Description of the categories of intangibles with underlying information (success factors)	
	Measurement within the dimension of quality, quantity and systematic
	Cause-chain-effect of success factor

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3.2 Proposal for reporting about intangibles within Management Commentary

German Commercial Code/GAS versus IC-Statements

2. Definition and measurement of indicators and their development

German Commercial Code/GAS	IC-Statement
Indicators for explanation	Definition of indicators and their determination
Description of the categories of intangibles with underlying information (Indicators)	Values of indicators for the current reporting year
Changes to previous year(s)	Values of indicators for previous years
Comparison of time	
	Target value of indicator for the next year

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3.2 Proposal for reporting about intangibles within Management Commentary

German Commercial Code/GAS versus IC-Statements

3. comment: judgment of the development with future-oriented information

German Commercial Code/GAS	IC-Statement
Qualitative and quantitative analysis, if necessary	Judgement of current indicators' value
	Judgement of indicators' value with reference to previous years
	Explanation of differences within target-performance comparison
target-performance comparison	
Reference to the anticipated development of the company (future-oriented)	Actions
	Planned investments
	Summarising to a overall picture (holistic view), description

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3. ICS as part of the Management Commentary

3.3 Result from a survey referring to the Management Commentary

Importance of the different parts of management commentary from the users' and preparers' point of view (scale 1 [= high] to 6 [= low])

	companies		financial analysts
	listed	not listed	
Business activity and economic and political environment	3,4	2,6	4,3
Information about research and development	5,3	4,9	5,8
➔ Report about the financial position (including information about not recognized intangibles)	2,1	1,8	2,1
➔ Subsequent events	5,1	4,6	5
➔ Risks and opportunities report	3,1	2,7	2,1
➔ Forecast	2,2	3,2	2,8

Kajüter/Bachert/Blaesing/Kleinmanns: Die DRS zur Lageberichterstattung auf dem Prüfstand, in: Der Betrieb 2010, S. 459

- Report to the financial position is of prime importance
- The future-oriented reporting (risks and opportunities report as well as forecasts) is of significance, too.

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3. ICS as part of the Management Commentary (MC)

3.4 Case: EnBW (a main German energy provider) - Structure of the MC

§ 289 German Commercial Code/GAS 15

EnBW (2009)

1. Business activity and economic and political environment
2. Financial position (→ including information about not recognised intangible assets)
3. Risk and opportunities report; Forecast
4. Subsequent events
5. Financial reporting internal control and risk management system

1. Group structure und business activity
2. Corporate Strategy and value-based Management
3. Economic and political environment
4. The EnBW Group
5. **The EnBW AG**
6. **Employees**
7. **Research and development**
8. Risk and opportunities report
9. Overall assessment of the economic situation of the group
10. Remuneration report
11. Subsequent events
12. Key features of the financial reporting internal control and risk management system
13. Forecast

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3. ICS as part of the Management Commentary

3.4 Case: EnBW (a main German energy provider)

Annual Report 2009

Unrecognised intangible assets

EnBW's success is also based on a range of intangible assets that are not recognised in the balance sheet. EnBW's human, structural and relationship capital, i.e. its intellectual capital, has a significant influence on the company's business operations and therefore reflects the business value of EnBW. Accordingly, the professional management of intellectual capital is a strategic challenge. EnBW is the only large company in Germany to employ intellectual capital reporting for this purpose based on the principle of "Intellectual Capital Statement – Made in Germany" and has been doing so since 2005. The factors influencing intellectual capital are assessed in a systematic self-assessment process by several employee groups that are representative in terms of the professions and hierarchies of their members. The quality and quantity of individual factors, such as corporate culture, motivation and customer relationships, as well as their systematic development are assessed with the help of 27 questions. The results from the key group entities are then used on a rolling basis¹ to give a group-wide overview of the development of intellectual capital. This way the company can identify areas for optimisation and then initiate, monitor and manage improvement measures.

(EnBW Annual Report 2009, p. 73)

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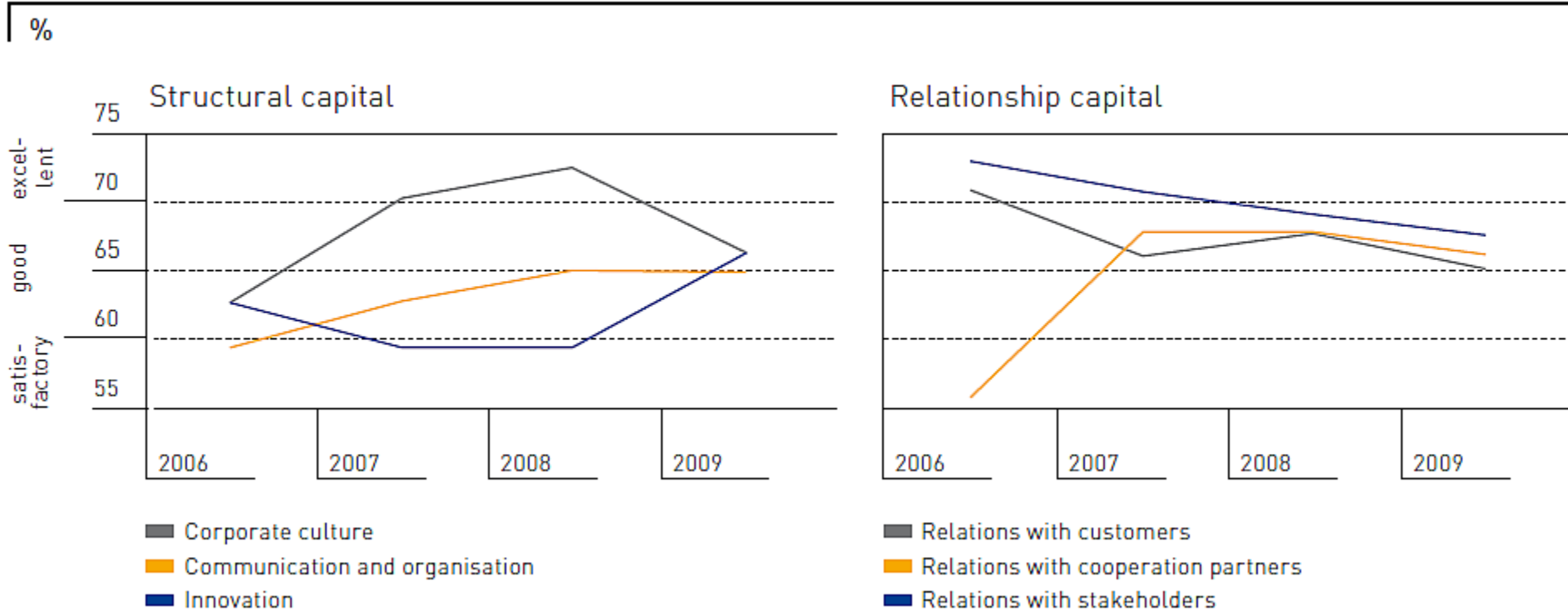


3. ICS as part of the Management Commentary

3.4 Case: EnBW (a main German energy provider)

Annual Report 2009

Development of the factors influencing the intellectual capital of EnBW



(EnBW Annual Report 2009, p. 74)

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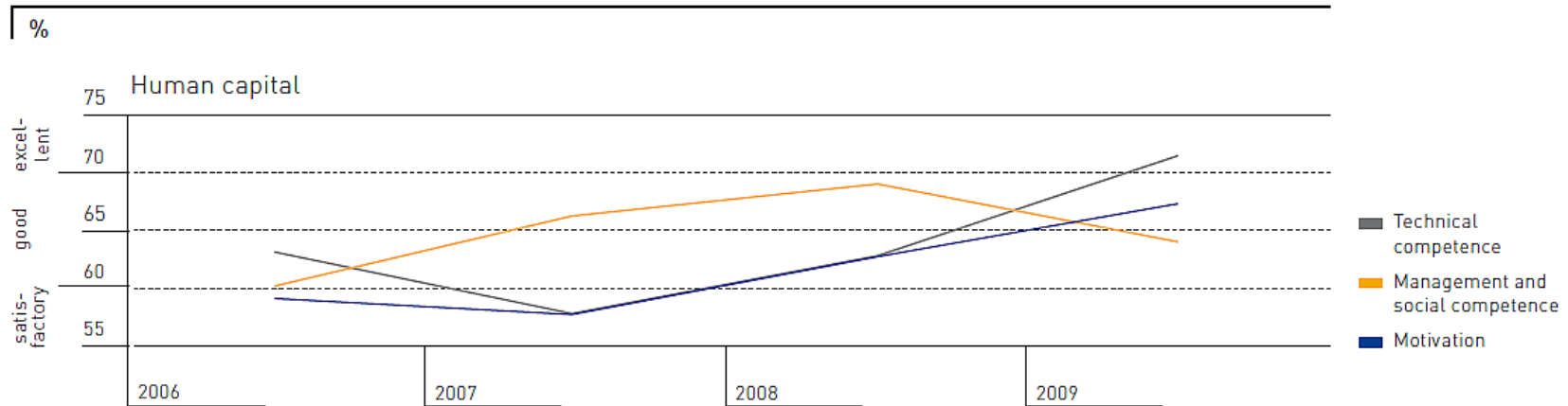


3. ICS as part of the Management Commentary

3.4 Case: EnBW (a main German energy provider)

Annual Report 2009

Development of the factors influencing the intellectual capital of EnBW



Since 2005, EnBW has assessed its human capital using the method “Intellectual Capital Statement – Made in Germany”. The company’s overall rating has been “good” since 2008. Technical competence was rated as “excellent” in 2009. This improvement is attributable to the fact that resources problems in prior years that were linked to the company’s growth and restructuring were resolved by creating new jobs and improving the system for finding and training staff. The rating for management and social competence improved continuously up until 2008 thanks to programmes introduced in the group. The rating deteriorated slightly in 2009, however, with a sharp rise in requirements on account of the company’s growth and the increasing complexity of the business having a negative impact. Management development programmes have not yet succeeded in adequately counteracting this development. The assessment of the motivation of the EnBW workforce has been developing positively since 2007, with the main reasons cited as an improvement in the situation with regard to resources as well as increasing stability after the changes experienced in prior years.

(EnBW Annual Report 2009, p. 83)

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4. ICS as part of the Performance Management Systems (PMS)

Earnings Capability Index (ECI™) - Definition

The ECI™ is a connection of classical company analysis extended with the experiences and results from the IC Statements.

ECI™ distinguishes between three categories and connects Strategic Management with Operational Management as follows:

- The success factors under competitiveness and ability to change show the strengths and weaknesses in the strategic process of the firm;
- The financial indicators are used to evaluate the current earnings status of the firm;
- The combination of financial and non-financial indicators gives a whole picture of where the firm stands in order to meet its future financial (and strategic) goals

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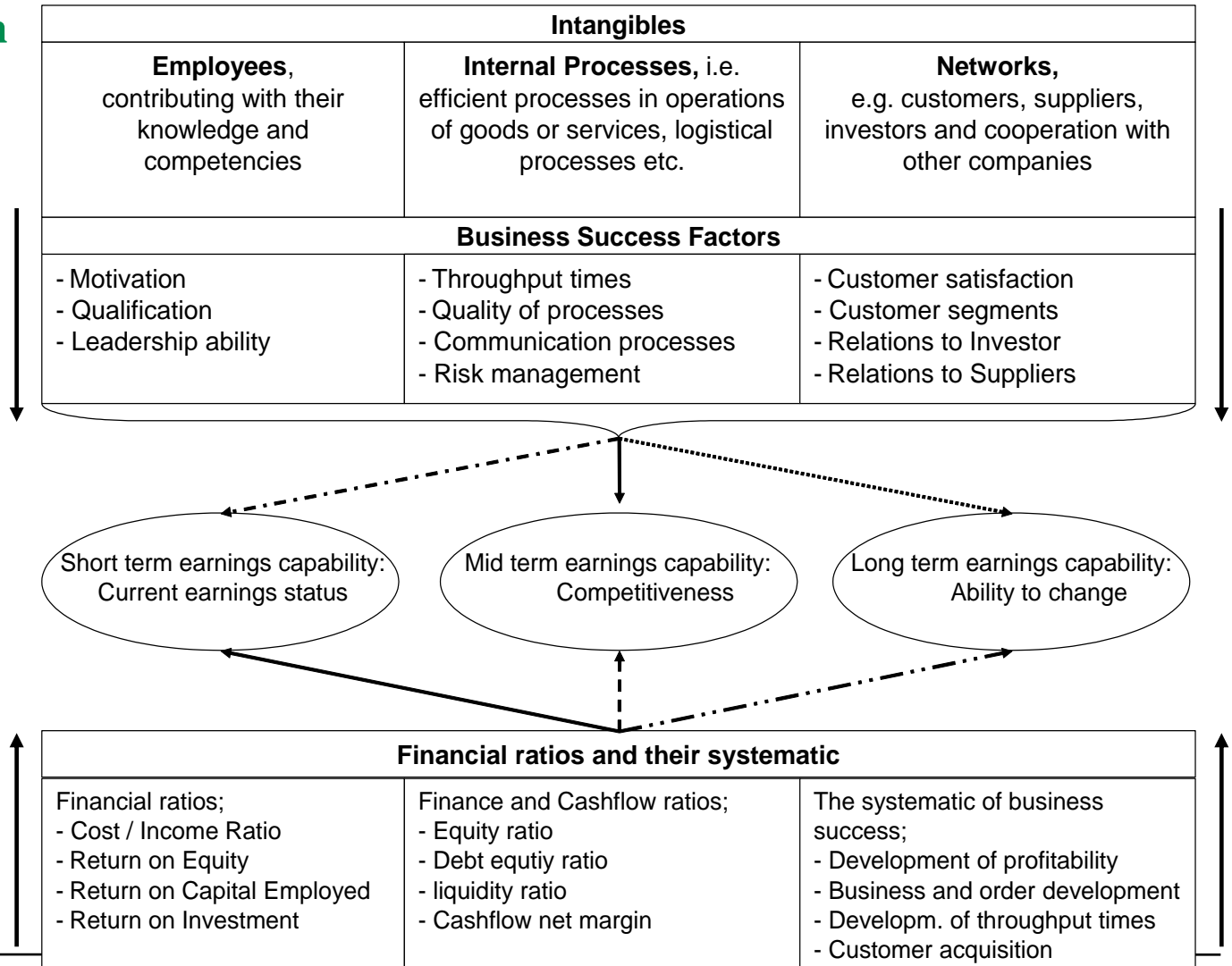


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4. ICS as part of the Performance Management Systems (PMS)

Impact of financial data and intangible success factors on the future earnings capability of a firm



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4.1 Case study 1

Future Earnings Capability based on classical financial data	Current Earnings		Competitiveness		Ability to change	
	Cost / Income Ratio		Customer Loyalty		Innovation and Growth Capability	
	Value	0,0 %	Value	0,0 %	Value	0,0 %
	Score	0	Score	0	Score	0
	Weight	1	Weight	1	Weight	2
		92		100		9
Future Earnings Capability based on classical financial data	Accrued Earnings		Customer Potential		Payroll Flexibility	
	Value	0,0 %	Value	0,0 %	Value	0,0 %
	Score	0	Score	0	Score	0
	Weight	2	Weight	2	Weight	1
		100		100		5
	Return on Equity		Market Penetration		Process Efficiency	
Value	0,0 %	Value	0,0 %	Value	0,0 %	
Score	0	Score	0	Score	0	
Weight	1	Weight	2	Weight	1	
	98		0		10	
Short term EC forecast		Mid term EC forecast		Long term EC forecast		
	91		67		8	

Earnings Capability Index	Earnings Sustainability		Quality and Systematic Relational Capital		Quality and Systematic Human Capital	
	Value	0,0 %	Value	0,0 %	Value	0,0 %
	Score	0	Score	0	Score	0
	Weight	1	Weight	2	Weight	2
		71		72		6
	Quality and Systematic Structural Capital		Interdependency Analysis HC, SC and R			
Value	0,0 %	Value	0,0 %	Value	0,0 %	
Score	0	Score	0	Score	0	
Weight	1	Weight	1	Weight	2	
	71		3			
Weighted Sum		Weighted Sum		Weighted Sum		
Weight short term	80 %	Weight short term	40 %	Weight short term	5 %	
Weight mid term	15 %	Weight mid term	40 %	Weight mid term	50 %	
Weight long term	5 %	Weight long term	20 %	Weight long term	45 %	
	92		64		6	
Short term EC forecast		Mid term EC forecast		Long term EC forecast		
	87		76		6	

Future earnings Capability based on classical financial data and indicators = 242 (= 91 + 67 + 84)

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4.2 Case study 2

Future Earnings Capability based on classical financial data

Current Earnings		Competitiveness		Ability to change	
Cost / Income Ratio		Customer Loyalty		Innovation and Growth Capability	
Value	0,0 %	Value	0,0 %	Value	0,0 %
Score	0	Score	0	Score	0
Weight	1	Weight	1	Weight	2
54		100		51	
Accrued Earnings		Customer Potential		Payroll Flexibility	
Value	0,0 %	Value	0,0 %	Value	0,0 %
Score	0	Score	0	Score	0
Weight	2	Weight	2	Weight	1
79		100		81	
Return on Equity		Market Penetration		Process Efficiency	
Value	0,0 %	Value	0,0 %	Value	0,0 %
Score	0	Score	0	Score	0
Weight	1	Weight	2	Weight	1
97		58		100	
Short term EC forecast		Mid term EC forecast		Long term EC forecast	
81		82		78	

Earnings Capability Index

		Quality and Systematic Relational Capital		Quality and Systematic Human Capital	
		Value	0,0 %	Value	0,0 %
		Score	0	Score	0
		Weight	2	Weight	2
		50		48	
Earnings Sustainability		Quality and Systematic Structural Capital		Interdependency Analysis HC, SC and RC	
Value	0,0 %	Value	0,0 %	Value	0,0 %
Score	0	Score	0	Score	0
Weight	1	Weight	1	Weight	2
68		51		35	
Weighted Sum		Weighted Sum		Weighted Sum	
Weight short term	80 %	Weight short term	40 %	Weight short term	5 %
Weight mid term	15 %	Weight mid term	40 %	Weight mid term	50 %
Weight long term	5 %	Weight long term	20 %	Weight long term	45 %
75		71		56	
Short term EC forecast		Mid term EC forecast		Long term EC forecast	
73		70		64	

Future earnings Capability based on classical financial data and indicators = 241 (= 81 + 82 + 78)
 Earnings Capability Index (quantitative and qualitative indicators) = 207 (= 73 + 70 + 64)
 → Difference: -34 Punkte = -14%

5. Conclusion

What do ICSs achieve – and what not?

- ICSs are a support for the management and employees within recognition and measurement of Intantibles.
With ICSs relevant management measures are revealed.
- ICSs do not measure Intangibles in monetary items

Usefulness of ICSs within accouting?

- Support within external comunication, e. g. Rating according to Basel II, in case of insolvency or company succession
- Support within Management: Derivation of strategic measures with a high impact on sucess factors.

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5. Conclusion

Challenges of ICS?

- The impact of investment in intangibles on the companies' success is not always cognizable and with time-lag.
Sometimes, there are problems of legitimation for the ICS-activities within the companies and its costs.
A rethinking is necessary: It is not only the short-term profit but the long-term profit which should be focussed.
- For reasons of comparability the reporting should meet specific principles and should be more or less standardized.
EFFAS has listed ten principles for the communication about intangibles from the capital markets' point of view (EFFAS, 2008) and the World Intellectual Capital Initiative (WICI) tries to find a global accepted standard for reporting about intangibles.

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