

## MEASURING THE RETURN ON KNOWLEDGE

*In the third and final article in her series on Knowledge Management, Dr. Deborah Swallow looks at the developments in the accounting world and proposes a new role for accountants. However, she comments: "How ironic that accounting is the last vestige of those who believe that things are assets and ideas are expendable!" Her previous articles were: Understanding Knowledge Management and Intellectual Capital and Taking Stock of Intellectual Capital.*

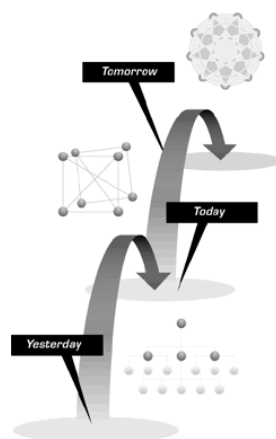
**"Top management are very much interested in ideas about the valuation of intellectual capital. They believe there is a premium on their intangible assets that should be added to their financial equity value".**



Rapid-fire developments in technology are changing the way businesses operate. Accounting is no exception. Traditional accounting methods can no longer adequately determine the real value of companies in the information age. As auditing becomes more speedy through computerisation, accountants need to focus on offering more value-added services and advice. In particular, one of the newest and possibly most critical, though contentious, issues facing accountants is the way they value intellectual capital.

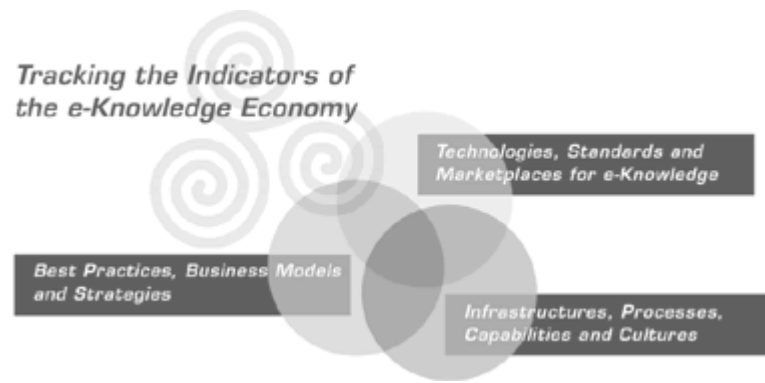
Valuing intellectual capital presents accountants with several obstacles as it is a non-traditional area of accounting. Unfortunately, there is no definitive interpretation. Intellectual capital has been defined as "goodwill," "knowledge and experience," and "what makes the company tick". Intangible assets are largely ignored by accountants who think it is just intellectual property which is just a small building block of intellectual capital.

The accounting bodies in both the United States (American Institute of Certified Public Accountants) and Canada (Canadian Institute of Chartered Accountants) are working to quantify intellectual capital. Canada's Chartered Accountants are collaborating with academics and business leaders, through the Canadian 'Performance Reporting Initiative', to provide innovative performance measurement tools that address information and reporting needs in areas such as:



- Intellectual Capital
- Knowledge Management
- Environmental Performance
- Social and Ethical Responsibilities
- Employee Well-Being
- Customer Satisfaction
- Innovation Capabilities
- Measurement of Shareholder Value Creation

The AICPA is putting together multidisciplinary task force to develop steps toward standardisation. "The task force is bringing together accountants, attorneys, researchers and business people because it is not strictly



CPA issue," says Joseph Agiato, managing director of intellectual properties for KPMG Peat Marwick. "It affects everybody." But, there is still no industry-wide agreement for auditing processes and certified measurements.

However, according to knowledge strategist, Paul Straussman, "Accountants are not interested in accounting for knowledge assets. They have not paid attention to knowledge capital and that is the problem. If you overpay for an acquisition, the accountants would say, 'Let's write it up as goodwill.' That is as far as they have been willing to go. Well, writing up value in excess of equity is not goodwill. It is what they have paid for knowledge capital. The phrase 'goodwill' does not mean much." One of the key tools that Stauszman has devised in monitoring intellectual capital is an Overhead-to-Asset Conversion Efficiency measure

Top management, however, are very much interested in ideas about valuation of intellectual capital. They believe there is a premium on their intangible assets that should be added to their financial equity value. There are certain models or methods based on good economic principles that organisations are using to measure intellectual capital. These include looking at intellectual capital from several angles, such as market, cost, relief-from-royalty, technology-factor and income approaches while the key concepts are:

- Linking strategy and performance measurement
- Managing explicit and implicit relations with stakeholders
- Using feedback to encourage organisational learning
- Communicating and linking performance measures, to foster understanding and commitment.

There are now several models being tried out around the world:

- In 1992 Kaplan and Norton brought out the Balance Scorecard which focused on aligning internal process initiatives to customer needs and financial goals. Underpinning the model is the assumption that 'innovation' or 'learning and growth' indicate future performance. Critics argue that the model resembles command and control systems targeted at financial goals and de-emphasises the role of people.
- Karl Erik Sveiby created the Intellectual Asset Monitor which is based on the underlying belief that people are the only generators of profit. Corporate and individual competencies are made explicit. The model includes both customers and suppliers and the internal structure/culture of the firm. It links these assets to the different operational strategies: growth, efficiency and stability. No precise financial targets are stated, unlike the scorecard.

- In 1995 Edvinsson devised the Skandia Navigator. The navigator takes into account the same set of financial, operational and customer concerns as the scorecard. But, it creates the need to consider the organisation, its structure and processes for nurturing its employees.
- The Roos brothers, in 1997 published their Intellectual Capital Index. Unlike static models described previously, this index provides a dynamic view of how these intellectual stocks can change over time. By simplifying the categories into indices, the model can predict returns as investment strategies shift.
- Swedish-based company Celemi worked with Karl Erik Sveiby and came up with the Celemi Intangible Assets Monitor in 1998. This encapsulates the best of what has gone before and enables people to quickly understand the changing needs of the business and react accordingly. This acts as a continuous knowledge improvement monitor.



A lot of companies downsize and outsource in order to increase efficiency without calculating the effect on their knowledge stocks. They slim down, reduce costs and destroy assets in the process and five years on find the company is in a worse shape than it was before. This is where the smart accountant of the future will win. According to Agiata, "Eighty percent of a company's value is intangible." This eighty percent includes distribution channels, customer relations, the work force and other intangible items that add value to the company. It is in helping manage those resources

efficiently that accountants can help their client companies become more efficient, more profitable and more competitive. The message is becoming very clear: the people who understand knowledge assets are going to be winners. Accountants can add value to their clients businesses by helping them manage knowledge assets as part of their strategy.

Some accountants may think that evaluating Intellectual Capital is just voodoo accounting. But, the thing has not yet been discovered that cannot be measured. The only thing that stops us is our imagination in creating new tools. All of this would seem to make a strong case for the systematic and universal measurement of intellectual capital. But old traditions die hard. As for now, the forces of status quo still reign.

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