

Intellectual Capital Accounting – how to measure the unmeasurable

Intellectual capital building blocks, elements, variables and indicators

Studies have managed to reach a consensus around the building blocks of intellectual capital. There seems to be some agreement that *human capital* and *structural capital* are two of the corner stones, although the term *organisational capital* is often used for the latter. However, talk about *relational capital* and ideas seem to become a little more confused: *customer capital* is certainly one of the aspects here although in some publications this classification comprises *alliance and partner capital*. In trying to capture the entire picture, *social capital* and even *cultural capital* may be added to the list. Nevertheless, once the main blocks are defined, specialists descend one step further into the depths of intellectual capital secrets looking to sum up all the elements that are part of the inventory of each major sphere. The ideas become more dispersed here but careful harvesting yields a list of 100 to 150 elements.

The next development concentrates on the attributes, variables and parameters that are linked to or characteristic of the element at stake. And that is where it stops. Intellectual capital reporting is primarily limited to indicators, which leads to the pertinent question... "What's the use of all this?"

Some managers who are confronted with the (sales) talk from intellectual capital accounting promoters are lured into starting an exercise, which is often called: the putting together of an Intellectual Capital Balance Sheet (Wissensbilanz in Germany and Austria). All of these projects start with the listing of chapters and elements and generate or calculate indicators at best. In many cases these Intellectual Capital Balance Sheets are then used for internal and/or external communications, i.e. as propaganda to show the innovative spirit of management. And then there is silence...

What is missing? The answer is simple and twofold:

1. The value of intellectual capital assets needs to be expressed in ONE, and the same, common denominator so that values can be added up and compared, i.e. money, the only measure known and understood by everyone;
2. The report format needs to be clear, known and understood by the average manager. Maybe a classical (financial) balance sheet format might fulfil this requirement.

Designing a report in balance sheet format is simple. Everybody talks about intellectual capital assets, which requires ordering these assets in a similar manner to the financial assets on a conventional balance sheet. This task is relatively easy. Financial assets are financed with equity (shareholders' capital) and external funds (banks, financial institutions, suppliers, creditors, etc.). The 'financing' of intellectual capital assets may be approached in exactly the same way. These assets are either owned

by the company (explicit) or are 'borrowed' by the company (tacit). Understanding this leads to the construction of the liabilities side of the Intellectual Capital Balance Sheet.

Intellectual Capital Accounting

If the Intellectual Capital Balance Sheet is what we want, then we have to decide what we need to do in order to get this report. Applying the basic accounting rules seems to get us quite far:

1. Designing an Intellectual Capital Chart of Accounts is not complicated because the asset list is pretty clear and complete;
2. Intellectual capital accounting rules are a bit more complicated. We start by looking for the 'events' that drive intellectual capital value in much the same way as we do for 'events' that drive general accounting. Things such as incoming invoices and bank statements, for example, should help us there;
3. Intellectual capital valuation rules are the core of the matter. In general accounting rules have been defined to calculate the value of stock, estimate the amount of bad debts, convert items expressed in foreign currencies, and depreciate fixed assets. Financial accounting prepares a picture of the past. Intellectual capital accounting looks to the future.

The main challenge is to come up with a valuation system which is transparent, auditable, repeatable (objective), and...simple. This basic principle is based on two components:

1. A component covering the book value of the element, based on items such as acquisition or construction costs, depreciation and amortisation;
2. A component covering the future potential value of the element, probably the net present value of future cash streams.

The former follows the same principles used for tangible assets, e.g. the building of a new plant (which is comparable to building knowledge in a staff member). The latter requires more complex econometrical formulas based on parameters and variables typical for each element.

Double Counting

One of the main points of concern in intellectual capital accounting is the question of avoiding double counting. *Human Capital* is needed to realise *Customer Capital*. Adding up both values may result in double counting of the same potential. The 4-leaf model helps in visualising this phenomenon.

Is Human Capital Euro equal to Structural Capital Euro?

Another major concern is the equality of the unit of measurement used, i.e. the monetary unit of all the asset values. Expressing all values in Euro for example does not mean that all these values are of the same nature. Special care has to be taken to assure comparability.

Conclusion

A lot has been done, but much remains to be done. Unless we are able to translate and present intellectual capital into a language and format that managers understand, interest in this area will remain primarily academic. Auditors will have to be convinced that intellectual capital valuations are based on sound rules that are transparent, objective and auditable. Equally, auditors will have to 'open up' to the need of the knowledge economy where the majority of the assets utilised in a company are not presently found on the balance sheet.