

Accounting in the Knowledge Era

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It is a beautifully-balanced system

Assets	Liabilities	Income Statement
dr/cr	dr/cr	dr/cr
+/-	-/+	-/+
	Equity	
	dr/cr	
	-/+	

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It told the story of operations

Assets	Liabilities	Income Statement
Cash		Revenue
A/R	A/P	
Finished		COGS
WIP	Loans	
Raw mat.		SG&A
		Net income
Equipment		
Building		
Land	Equity	

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It served well through industrial era



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We've lost the operating story

Assets	Liabilities	Income Statement
Cash		Revenue
A/R	A/P	COGS
Fin	Loans	
WIP		SG&A
Raw mat.		Net income ←
<u>IT equipmt</u>		
Equipment		
Building		
Land	Equity	

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The difference is knowledge



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How knowledge is different

- It is not finite
- It is usually not owned
- It is usually not separate (exception IP)
- The value is determined by the total potential market

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In an organization

Knowledge = Intellectual Capital

- Human Capital
competencies, skills
- Network Capital
relationships with customers, suppliers and partners
- Structural Capital
processes and intellectual property
- Strategy/business recipe

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Knowledge reporting today

- Intangibles booked on balance sheet only when acquired through a transaction
- Valuation based on discounted cash flows
- Internally-created intangibles not reported
- Almost all spending on intangibles flows through the income statement (but not broken out) –even though this spending represents an investment

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Related trends

- Fair Value
- IFRS
International financial reporting standards
- XBRL
Extensible business reporting language
- EBRC
Enhanced business reporting consortium
www.ebr360.org

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Agenda for the future

- Inventory
 - Cost (intellectual capital expenditure)
 - Assessment (strength, outlook, risk)
 - Performance (leading indicators)
- These eventually will be housed in accounting. Not common today.

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Accountants are key to unlocking the power of corporate knowledge.....

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Inventory

- Human Capital:
 - Core competencies
 - Management practices
- Relationship Capital:
 - Key customer group/segments
 - Key partners (outsourcing, co-mktg, co-mfg.)
 - Key vendors
 - Brand

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Inventory continued

- Structural Capital:
 - Key value creation processes (related to how to you get paid)
 - Key business processes (such as finance and human resources)
 - Documents/captured knowledge (training manuals, know-how)
 - Intellectual property (patents, trademarks)

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i-capex = intellectual capital expenditure

- Every company continuously invests in intangibles (IT/processes, training, branding, innovation)
- Cost is actually the one universal and tangible metric available for intangibles
- These costs should recorded in an IC inventory
- Emerging accounting research about cost
<http://www.melbourneinstitute.com/wp/wp2005n15.pdf>

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Assessment

- Judges the strength and suitability of intellectual capital
- Good questions are around current capacity, future capacity and risk
- Focus should be assets versus strategy (e.g. do we have the right competencies to fulfill our strategy)
- Scale can be 1-5, red/yellow/green, etc.
- Good sources: management team, internal and external stakeholders
- This is a new kind of balance sheet

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Performance

- Focus here is on linking financial metrics with leading indicators
- Common approaches:
 - Balanced Scorecard
 - Dashboards
 - Performance management systems
- Ex: if an organization is working toward a goal of lowering returns by improving a customer service process, how will can progress be tracked?
- This is a new kind of income statement

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