'The concepts and conventions of accounting provide very clear guidelines for the accounting of assets within the balance sheet'.

Knowledge is becoming the new engine of corporate development with fewer companies relying heavily on tangible assets such as machinery and buildings to measure their value. Successful companies are more inclined to invest heavily in their employees and knowledge base, which prompts the question, How much are they really worth?. Intangible assets such as knowledge and patents are often over looked in company accounts whilst more forward thinking organisations have realised that these are an integral part of their business.

Historically the failure to include intangible assets in financial accounts has fuelled the confusion as to their precise description. Henderson and Peirson 2002 described intangible assets as 'rights rather than objects'. The International Accounting Standards (IAS) defines an intangible assets as an 'identifiable non-monetary asset without physical substance'. It would seem reasonable to expect a degree of inconsistency with regard to their treatment in financial accounts especially in light of the above definitions. The article from 'Accounting' magazine mentions the vast sums of money (£1m) spent by Consignia to change its name back to Royal Mail, which is a perfect example of the necessity to include such intangible factors within the financial accounts. Examples of more intangible assets are indicated below:

- Computer software
- Patents
- Copyrights
- Customer data bases
- Licences
- Customer and client relationships

At the height of the dotcom boom, many newly formed companies had practically zero assets but managed to value their shares more highly than key British and even Global performers. Investors who have become understandably wary of such 'one minute wonders' have put pressure on companies to identify their intangible assets as clearly as possible. It is not just investor pressure that is making companies become more transparent, forthcoming legislation in the Companies Act 2003 will require them to provide 'qualitative as well as financial evaluation of performance'. Traditionally the only recognised intangible assets to be considered in company accounts were patents and trademarks but failure to include a more detailed valuation of the organisation could have damaging effects at all level. An organisation that fails to include such intellectual property is one that doesn't fully understand it's own business model and hence unable to assess future business opportunities as effectively as others. Critics have often blamed the inability of many organisations to submit transparent accounts for the spectacular market failures over the last few years (Holland 2002).

So why are intangible assets and intellectual capital so hard to measure in company financials if they are so important to the future success of organisations. Accounts were traditionally designed to measure tangible items such as machinery and buildings and secondly some intangibles are much harder to measure than others. Companies such as the pharmaceutical giant, GSK as mentioned in the case study place considerable value on innovation and market differentiation, but what is important to one company may be worthless to another. This creates another problem for the finance managers as how can you place a value on creativity. Intangible assets can be separated into Human capital, Relational capital and Organisational capital, example of each are shown below:

Human capital

- Know-how
- Education
- Qualifications
- Work related knowledge

Relational capital

- Brands
- Customers loyalty
- Channels
- Company names
- Company logos

Organisational capital

- Patents
- Copyrights
- Design rights
- Trade secrets

As mentioned earlier in this discussion the financial reporting for intangible assets has been evolving over the last 20 years with the introduction of the first standard for reporting goodwill by the Accounting Standards Board in 1998. They are defined by the ASB as 'non financial fixed assets that do not have physical substance but are identifiable and controlled by the entity through custody and legal rights' The main objectives of this standard were to ensure that capitalised goodwill and intangible assets were charged to the P & L account. There must be sufficient information included within the accounts to enable potential investors to assess the true impact of goodwill on the overall performance of the company (Accounting Standards website).

Although unlikely that intangibles will appear compulsory on every firm's accounts the introduction of the Companies Act 2003 requires all large public sector companys to produce an OFR (Operating and Financial Review). The OFR requires the firms to account for intangible assets impact the overall financial performance. The key areas that have to be covered by the OFR are the 'dynamics of the business' such as future trends and investment programmes, financial risk, customer dependencies, R&D and training. The ASB provided guidance in January 2003 for the contents of the OFR's and stipulated that it should include commentary on the following:

- Corporate reputation
- Intellectual capital
- Licenses
- R&D
- Trademarks and copright
- Customer relations
- Market position and dominance

(CIMA website)

This discussion has focused on the importance of intangibles to organisations and highlighted the complexity of recording these in the financial accounts, as large investments in intangibles don't appear as positive assets in traditional accounting methods. The comments of one senior accountant (Nick Winters, PKF 'Accounting Magazine') shone much sceptism on how the inclusion of intangible would actually work in practice as the 'balance sheet would be jumping up and down all over the place'. He concludes that despite these problems 'it would be ridiculous for a business with good ideas not to put them down in the balance sheet, but in practice it is much more difficult'. It is highly likely that a recognised model for accurately recording the value of intangibles will take a long time to develop but it extremely important that organisations continue to experiment with different approaches as modern day investors require a much higher degree of transparency.

Word count: 975

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