

Accounting for intangibles: Financial reporting and value creation in the knowledge economy

A research Report for The Work Foundation's Knowledge Economy Programme

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The objectives of the project

- ◆ To understand the needs and interests of the multiple actors with interests in how intangible assets are to be accounted for
- ◆ To bring clarity and coherence to the disparate debates about the role (and reporting) of intangibles
- ◆ To investigate the implications of the role and reporting of intangible assets for organisational change amongst firms and institutions
- ◆ To facilitate discussion about an holistic approach to the development of public policy around intangibles



Our thesis

The incapacity to properly capture and represent in everyday practice intangible assets that we know to be valuable drivers of economic activity is the **'Value Paradox'** at the heart of the knowledge economy.



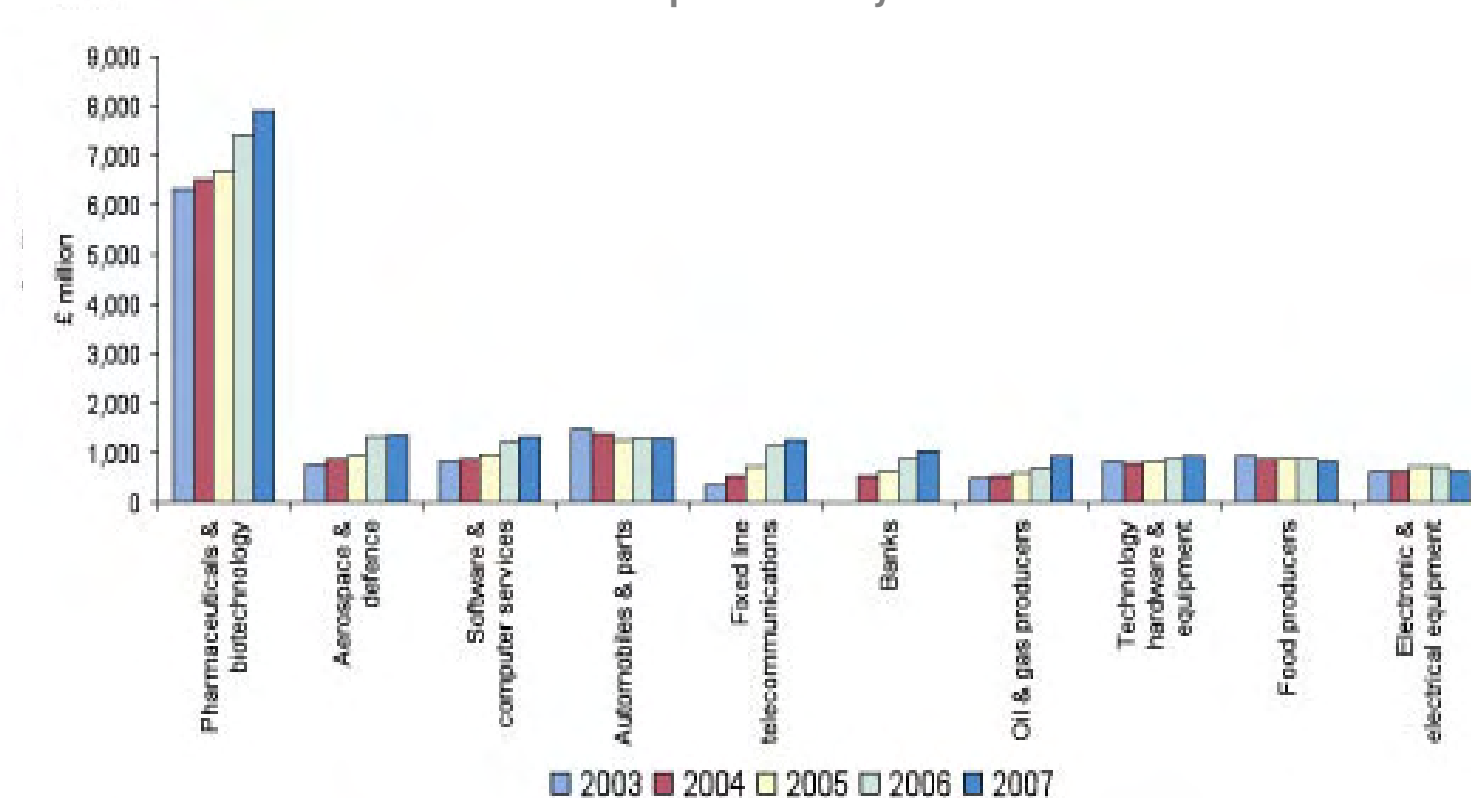
The macroeconomics of the knowledge economy

- ◆ Excluding intangibles from the national accounts distorts estimates of GDP growth, Total Factor Productivity growth, the value of corporate equity and even labour hours at the macroeconomic level.
- ◆ A significant proportion of intangible investment in the UK escapes current macroeconomic measurement.
- ◆ Business investment in the UK (2004) would have been more than double official measures had intangible assets been included. Tangible investments in the UK were approximately £96bn in 2004, intangible investment was £123bn



How useful is R&D as a proxy for intangible investment?

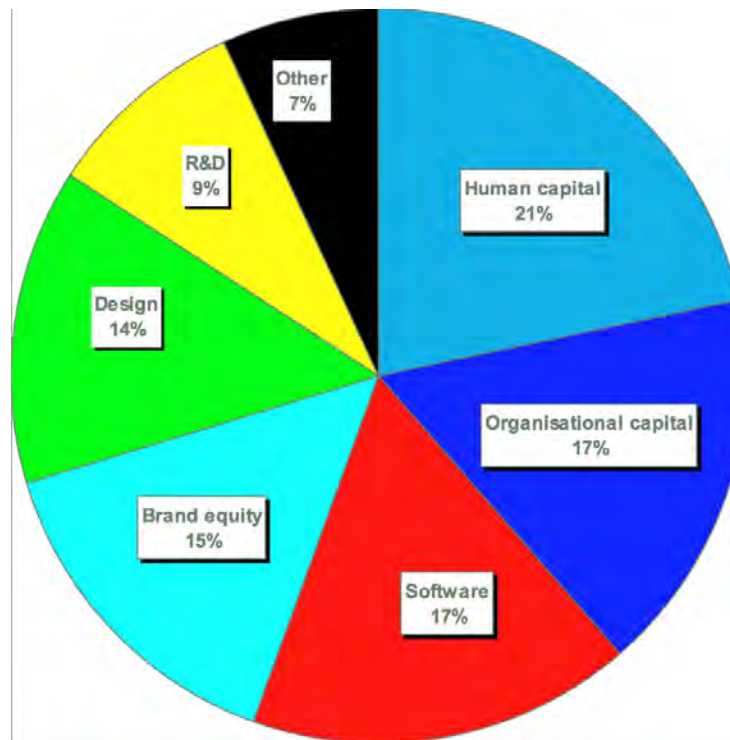
Growth in R&D expenditure by sector across UK850





The macroeconomics of the knowledge economy

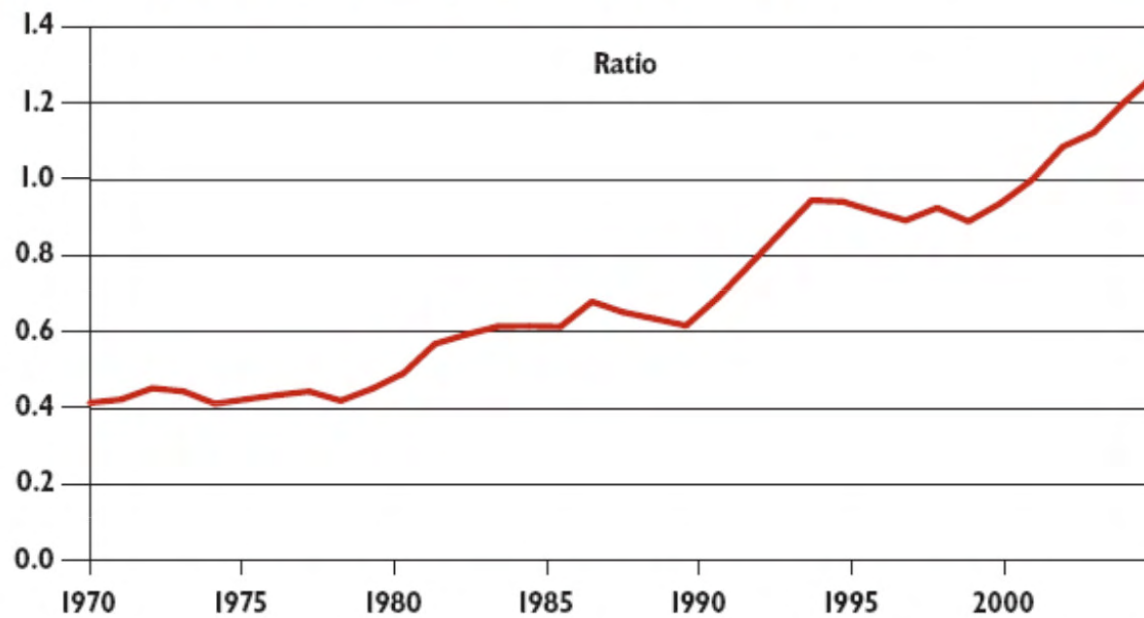
UK Business Spending on Intangibles in 2004





The growing importance of intangibles to the UK

Figure 1: Ratio of intangible to tangible investment in the UK 1970-2004⁹





Accounting for intangibles in the firm

- ◆ The general case for accounting and reporting reform
- ◆ The proliferation of value measurement frameworks
- ◆ Accounting for goodwill
- ◆ Accounting for R and D
- ◆ Accounting for brand



Accounting for intangibles in the SME sector

- ◆ Why should SMEs be interested in accounting for and reporting on their intangible assets?
- ◆ Characteristics of SMEs make it difficult for them to collateralise their intangible asset base.
- ◆ This may explain why, Europe-wide, the lack of appropriate sources of finance were particularly acute for small businesses, for those engaged in innovative activity and for those delivering intangible-driven business services.



Accounting for intangibles in the public sector

- ◆ A significant proportion of public sector IP and other forms of intangible assets remain unrecognised and under-developed
- ◆ No single model for IA use and exploitation in the UK public sector, reflecting fundamental differences in approach to IA ownership and management across the public sector: e.g. commercial exploitation vs. 'gifting'
- ◆ There are overt tensions and potentially conflicting incentives, between commercialisation and the 'public task'.
- ◆ There remains a huge potential for the more creative exploitation of IAs in the public sector



Economic, social and democratic returns from 'gifted' Public Sector Information

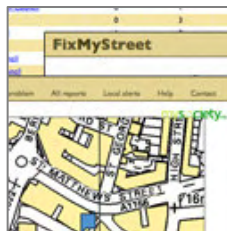
mysociety.org

„Using our services, **200,000** people have written to their MP for the first time, over **8,000** potholes and other broken things have been fixed, nearly **9,000,000** signatures have been left on petitions to the Prime Minister,,



TheyWorkForYou

„TheyWorkForYou was visited around **two million times** in 2007 (according to Google Analytics) and has become a small institution in British politics.“



FixMyStreet

„Nearly **25,000 problems** have now been reported across the UK, with our users following up many thousands with updates, news and notifications that problems have been fixed. ,,

Source: Cabinet Office

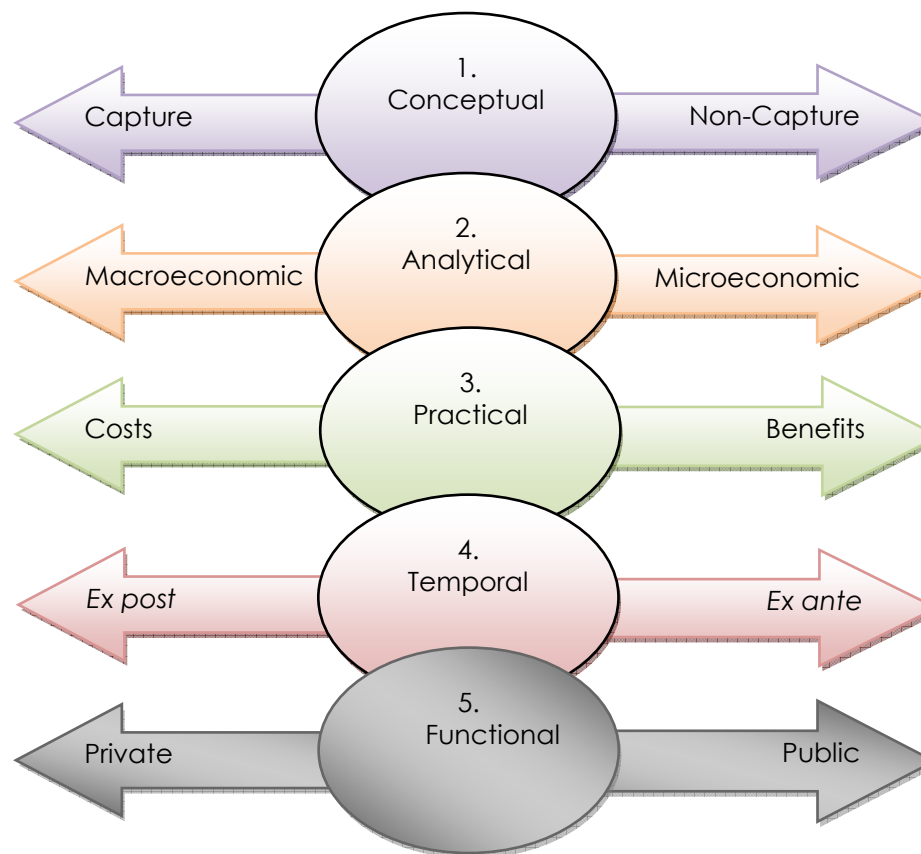


We are at an impasse

- ◆ Current debate is at an impasse, and has been so for a number of years.
- ◆ Accountancy practices clearly need to change but there are few means available to effect such change.
- ◆ There is no 'golden' metric for intangible value, and accountancy is not designed to deliver one even if there was.
- ◆ The problem of intangible asset accounting and reporting has been misconceived: The Value Paradox pertains to more than whether or not IAs can be better captured.



The (5 dimensional) Value Paradox...





...and what we might do about it

- Reform of accounting and reporting practice
- National accounts
- SME finance
- Public Sector Intangibles
- Greater co-ordination in industrial policy

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