



19th UN/INTOSAI Symposium
19^e Symposium ONU/INTOSAI
19. VN/INTOSAI Symposium
19° Simposio NU/INTOSAI

28 – 30 March 2007, Vienna, Austria / 28 – 30 mars 2007, Vienne, Autriche
28. – 30. März 2007, Wien, Österreich / 28 al 30 de marzo de 2007, Viena, Austria

Topic/Thème/Thema/Tema

- SYMPOSIUM ON VALUE AND BENEFITS OF GOVERNMENT AUDIT
IN A GLOBALISED ENVIRONMENT •
- SYMPOSIUM SUR LA VALEUR ET L'AVANTAGE DU CONTRÔLE DES FINANCES PUBLIQUES DANS
UN CONTEXTE MONDIALISÉ •
 - SYMPOSIUM ÜBER DEN WERT UND NUTZEN
DER ÖFFENTLICHEN FINANZKONTROLLE IN EINEM GLOBALISIERTEN UMFELD •
- SIMPOSIO SOBRE EL VALOR Y LOS BENEFICIOS DE LA FISCALIZACIÓN PÚBLICA
EN UN CONTEXTO GLOBALIZADO •

- THE VALUATION OF THE "INTANGIBLES" OF AN ORGANISATION BY MEANS OF
INTELLECTUAL CAPITAL REPORTING

BASIC PAPER / RAPPORT DE BASE / GRUNDLAGENPAPIER / PONENCIA BASE

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In the private sector, the difference between the book value and the market value of a company (for listed companies defined by the share price) has given rise to the belief that the value of a company is determined as much by what is reported in the balance sheet as by other valuation parameters. Surveys carried out by US banks even suggest that the intangibles have long overtaken the tangibles traditionally disclosed in financial reports, at least as far as the percentage of fixed business investment in GDP is concerned (Fig.1).

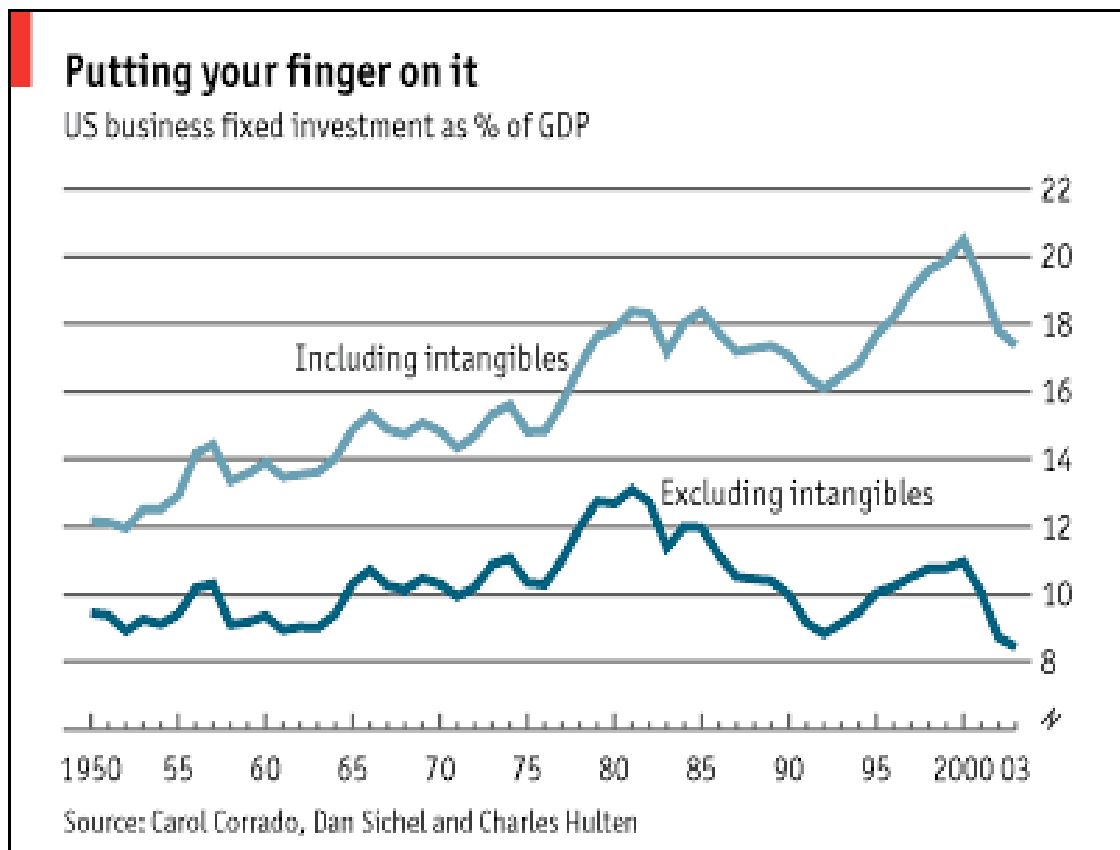


Figure 1: Business investment in the US, including and excluding “Intangibles”

As all service providers from government authorities to knowledge-based entities, including SAIs, are undergoing transformation, knowledge and skills have become an instrumental factor for success, ahead of the “hard” work skills that have been considered to date as the key competencies of an organisation. This must be reflected in new and appropriate approaches to analysis and reporting.

Scientific institutions such as research centres [1] have championed these new methods of reporting and analysis, as conventional micro-economic indicators are able to capture their performance only inadequately. Universities, for instance,

consider the academic success of students and teachers (expressed by the number of publications and their impact on the scientific community, or the number of top-level qualifications (Ph.D. students) for the domestic market, or research awards) as being far more important for their competitive position and international ranking than “just” sound financial management.

Under the new Austrian University Act of 2002 (Universitätsgesetz), every university must present a statement on their intellectual productivity in the form of an intellectual capital report. (Detailed implementing legislation has been in place since 2006 [2]). The intellectual capital report is the basis for public-service agreements that are concluded for a three-year period between the government which has funding responsibility for higher education and a given university. As the share of government funding (target of up to 20%) depends on the results reported in the intellectual capital balance, universities are incentivised to compete for funding in a manner Europe is not accustomed to.

Besides research organisations and universities, a number of leading companies have adopted intellectual capital reporting as a strategic planning and controlling instrument, more than as a reporting tool. Austrian organisations have been ground-breaking in this field. In 2003, the Austrian Central Bank was the first such institution worldwide to supplement its annual report by an intellectual capital report. In 2001, Böhler-Uddeholm, an Austro-Swedish steel manufacturer with worldwide operations, was the first corporate group to use this instrument to highlight its intangibles. Starting out in Germany in 2002, intellectual capital reporting made its way to several other European countries and is gradually spreading all over the globe. In Europe, some 500 companies currently use this reporting method.

In 2006, the European Commission released a high-level expert group report on intellectual capital reporting under the heading RICARDIS [3], which analyses the benefits of intellectual capital reporting, provides an overview of different methodologies, and addresses yet unsolved research issues. The report concedes that intellectual capital reporting is still a novel process in need of consolidation, while at the same time stressing the instrumental need to disclose the intangible elements in the value that is created, notably by knowledge-based organisations

SAIs, by their mandate and the way they understand their mission, are typical knowledge organisations. One of their goals is to raise the competence of the institutions they audit by offering advice based on their own methodological competence. The Austrian Court of Audit has subscribed to this strategy and, consistently, launched a project which bases itself methodologically on the framework and reference standard of the intellectual capital reporting model of

Koch & Schneider [4], which is most frequently used in Europe. This model tries to map the correlation between economically and financially recordable and non-financial performance parameters, as is expressed by the notion of “intellectual capital” that is made up of the terms “intellectual” and “capital”.

The model consists of five stages that are to be completed in the process of intellectual capital reporting (Fig. 4): (1) Strategic objectives, derived from its mission and vision, which are both strategic goals for the “knowledge development” of an organisation; (2) Knowledge management as an operational achievement of mastering the various elements in this model professionally; (3) Stating “capital” and organisational competences in the four recognised standard categories of “human capital“, “structural capital“, “relational (networking) capital“ and “innovation capital“; (4) The key processes (=procedures) of the organisation, of which the audit process and its sub-processes constitute the core process (Fig. 3), and (5) The generated (= tangible, i.e. mostly financial, and non-tangible) results, which remain at least as “enrichment” for all stakeholders of the organisation, or - preferably - should be continuously aggregated in the future.

The „Architecture“ of an Intellectual Capital Report for analysing the knowledge of an organisation

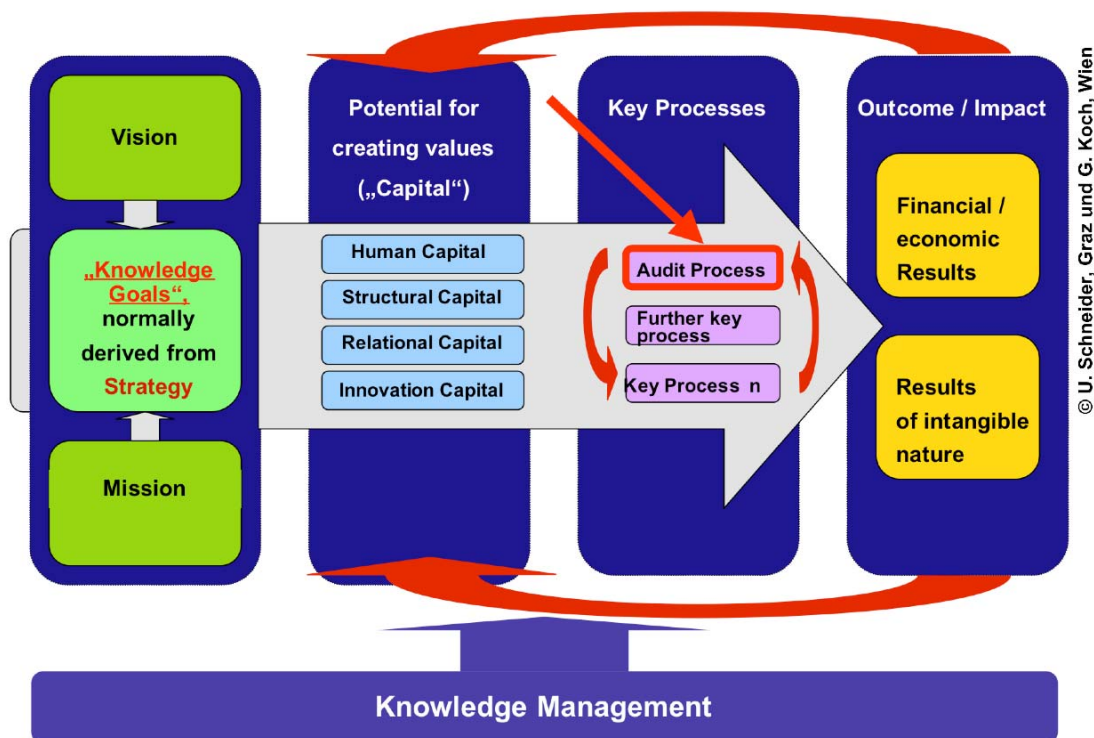


Figure 2: The Framework and Reference Model for Intellectual Capital Reporting

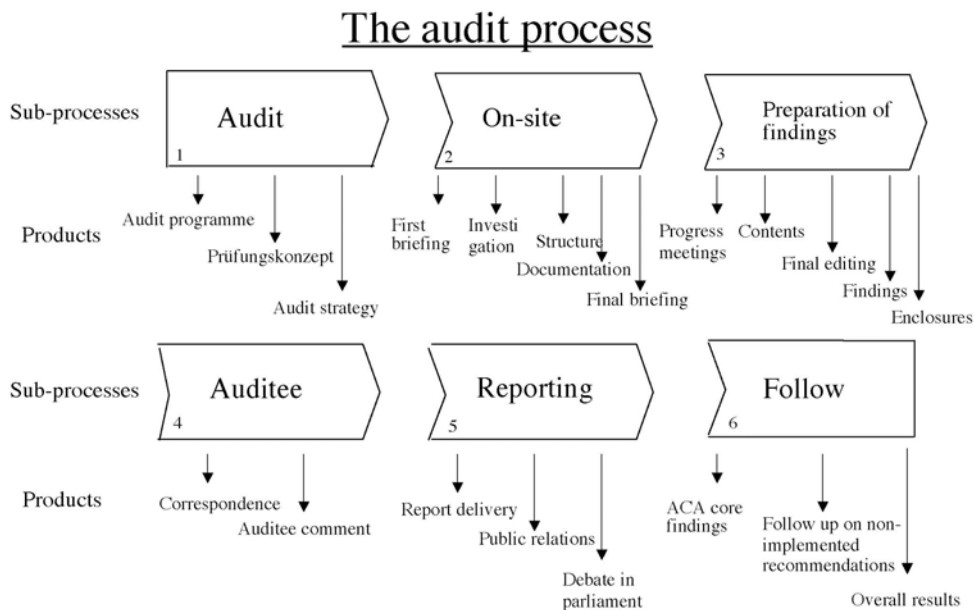


Figure 3: Zooming of a partial aspect of an intellectual capital balance: The audit process and sub-processes at the Austrian Court of Audit.

These five complexes, of which the sub-complex presented in Fig.3 is just one partial aspect of the “key processes“, are mapped in an intellectual capital report in a way that allows the owner of the intellectual capital balance as well as all stakeholders to understand the causal interrelations and use their conclusions as a basis for strategic and planning processes in the future. An intellectual capital report is designed to provide an overview of the knowledge-managed organisation, in other words an understanding of how things interrelate in an overall context, and at the same time identify specific fields where intervention is called for to improve performance individually at critical points or across the entire organisation.

The model framework is broken down by five steps that need to be completed in the course of an intellectual capital reporting project according to its different stages. In practice, every one of the five complexes with its sub-complexes needs to be defined by means of a set of indicators, the majority of which are rendered quantifiable through recorded or recordable data and such become measurable. These indicators can be classified as follows:

1. Indicators which are recorded at every SAI and form the basic set for comparability (benchmarking);
2. Indicators relevant for a specific SAI depending e.g. on its constitutional position;
3. Indicators that are considered instrumental for internal reasons, but are less relevant in general terms.

The publication of intellectual capital reports is a delicate issue. For good reason, comprehensive versions are prepared for internal use, while the publicised version tends to be an excerpt released specifically for this purpose. (For a potential benchmarking between SAIs at an international level, the selection criteria for indicators to be included in the benchmark still need to be identified).

The Austrian Court of Audit is currently engaged in a project to prepare a master report on its intellectual capital. Some 150 indicators are currently being discussed for inclusion, although this figure is not a yardstick for the quality of any such report. Intellectual capital reports in the future will aim at making do with fewer, but more significant derivative indicators.

By transposing the intellectual capital balance model presented in Fig.2 into a report document a structure as shown in Fig.4. is generated.

Planned Structure of the Intellectual Capital Balance of the Austrian Court of Audit (ACA)

<p>1. <u>Strategic basis</u> Mission statement [5], knowledge as a resource, knowledge goals (e.g. five goals for 2007: excellence, creating value, sharing principles, leading by example, international integration)</p> <p>2. <u>Knowledge management</u> Organisation/processes, levels, supporting pillars</p> <p>3. <u>Potential for creating values</u> Human capital, structural capital, relational capital, innovation capital</p> <p>4. <u>Core processes</u> Audit process, expert assessment of draft legislation, federal financial statements, developing staff knowledge Other processes</p> <p>5. <u>Results</u> Output = performance, Outcome & Impact = generated effect</p> <p><u>Annex: Glossary:</u> Definition of terms and indicators</p>
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Figure 4: Transposition of the model (Fig.2) into a reporting structure as used at the Austrian Court of Audit

What significance do innovative approaches such as intellectual capital reporting have for SAIs?

As SAIs are seeing their roles as financial auditors diminishing, and increasingly act as consultants for the management of service-providing organisations which are funded by or administer public resources, they are expected to manage forward-looking analytical approaches that are, above all, consistent with the needs of government administration. The audit of the formal correctness and efficient use of public funds has been refined to perfection, both methodologically and technically (thanks to information technology). Audits carried out by an SAI often lack an analysis of whether public funds were a) invested and managed consistent with strategy or mandate; b) to what extent an audit does not only analyse econometrically quantifiable performance, but also non-monetary performance which every state needs and which cannot be mapped by conventional micro-economic parameters (e.g. the implementation of a mandate according to budget) alone. Findings which are of genuine interest for an SAI concern the strategy, effectiveness and efficiency of policy implementation, as well as the quality of management, the substance and sustainability of activities performed by public

organisations, which determine the internal and external competitiveness of any given state. These questions are what the European Commission had in mind when it proclaimed the strategic goal of Europe becoming one of the most competitive knowledge-based economies in the future according to the Lisbon objectives.

From the perspective of a researcher, state-of-the art, methods-based analytical and reporting approaches such as intellectual capital reporting provide a necessary tool that can be further developed in the future.

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