

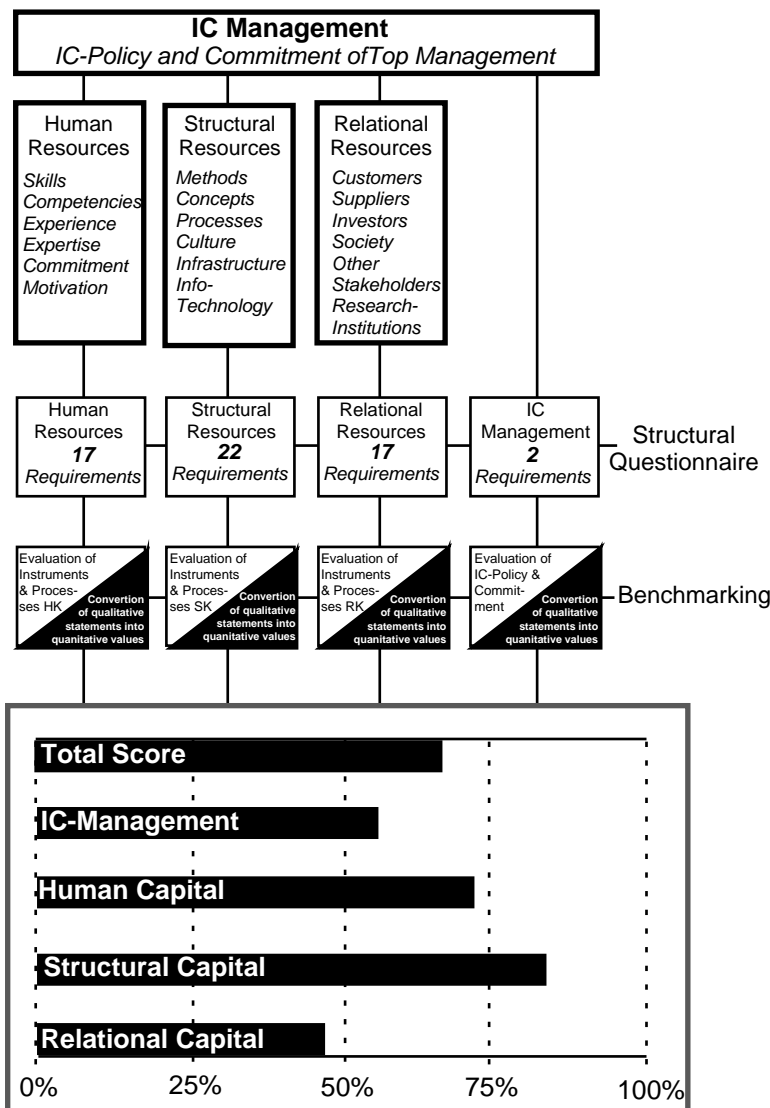
Evaluating Immaterial Assets:

~~As good as possible?~~ -> As good as necessary!

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0. Abstract: INTRATE-15649 for speed-readers

INTRATE-15649 is a simple, practicable tool to rate immaterial assets (Intangibles or Intellectual Capital > IC) of Knowledge based organisations.



Similar to Corporate Governance and Sustainability ratings, the reporting form is based on a self-declaration, which is raised by a structural questionnaire. The subject of research is the whole spectrum of Intangibles (human, structural and relational resources)

This ends up in 58 requirements for specific resources processes. The qualitative nature of the statements is converted into quantitative figures by using reference taxonomy. Thus, it is possible to reach benchmark capability.

The INTRATE report consists of bar diagrams for each of the intangibles categories. They show the status of an organisation in relation to a maximal reachable score. This proceeding generates transparency, where and which deficits are present.

INTRATE-15649-Reports are suitable for enterprise evaluation (indicator of the innovation competence & survival perspectives); for creditability reviews (catchword *Basle II*); for succession procedures and M&A; as “internal fitness check” and as complementary communication tool in annual reports, sustainability reports and in Corporate Governance.

Conclusion: INTRATE-15649 is a procedure that offers insight in the sustainable treatment of the so-called most important resource in short time and at low costs.

Detailed INTRATE-15649-Description and background information on the following pages

1. Why evaluating Intangibles?

Intellectual Capital (IC) or its synonym *Intangibles* is in these days widely acknowledged as being an important resource and an innovation driver. Different stakeholders (especially investors) ask for IC disclosure in addition to financial figures in the conventional annual reports (*1).

Target groups of *Intangibles Reports* can be separated in internal and external groups. Internally, this covers mainly the strategic management, while the *Intangibles Reports* for external communications aims toward carriers of scientific institutions, financial markets, potential employees, suppliers, customers and partners. Pioneer of *Intangibles Reports* is the Swedish financial firm Skandia. Since 1995, this company adds to its conventional annual reports an Intangible Report, which became famous with the name *Skandia Navigator*. In Germany, the ministry of economy and labour (BMWA) launched an initiative to promote *Intangibles Reports* as a strategic tool to acquire, measure and present immaterial assets for German middle-class organisations. In Austria, a new law obliges all universities to publish *Intangibles Reports*.

Even national and international accounting standards (IAS 38, DRS 12, IFRS, Basle II) recommend to annex of immaterial assets to conventional annual reports.

*Statement of **Günter M. Szogs**, Commerzbank, at the Seminar Knowledge Worker Productivity, St. Gallen 04:*

Basle II is primary focussed on the new rules concerning the required liability capital of banks. In addition, it takes considerable influence on the detection and control of risks. This happens by using new ratings with a strong influence on the sum of credit costs. Those ratings include questions about knowledge based enterprise management too.

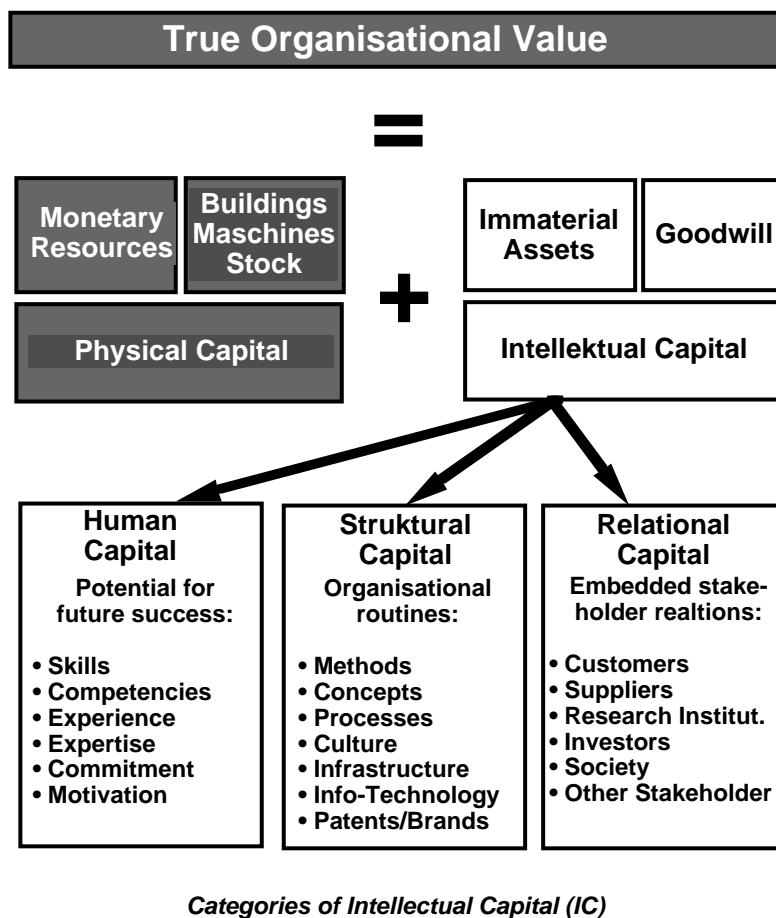
Investment professionals have discovered the intellectual capital as being major criterion for enterprise evaluation too. That confirms a statement from the highest reputation position:

*Extract of a speech by **Fritz H. Rau**, **President EFFAS** (European Federation of Financial Analysts Societies) given October 2005 at the University of Ferrara, Italy.:*

The speculative bubble seen at the end of the 1990s and the subsequent crisis suffered by equity markets emphasised, in our view, the limits of traditional analysis and valuation tools, as well as the shortcomings in standard accounting methods, often incomplete with regard to some fundamental value drivers. We investment professionals believe that these are two sides of the same issue and that, as a result, solving one side (analyses and valuations that are more in keeping with the underlying business operation) leads to the solution for the other side (improving the quality and quantity of information regarding intellectual capital within a business).

*The complete speech (*2) of Mr. Rau can be downloaded from www.hrm-auer.ch/english_docs.php*

2. Fundamentals of Intellectual Capital > Intangibles



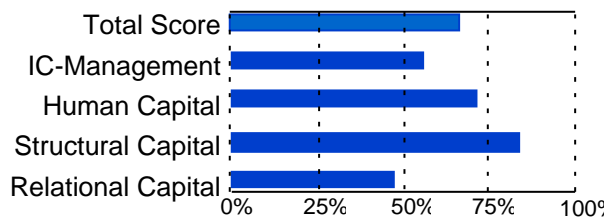
Intellectual Capital is often described as the difference between the market- and the booking value of an enterprise. It is undisputed that the Intellectual Capital represents the most important asset of a knowledge-based organisation. This value is usually not declared in annual reports and does not appear in conventional analysis models. Intellectual Capital must be converted into knowledge resources to formulate an Intellectual Capital statement. The most common classifications or types of knowledge resources are technologies, processes, stakeholders and employees.

The three components of IC are interactive: The human Capital raises the Structural Capital; both together generate the Relational Capital. The presence of resources is not sufficient to create value: for example, there is no correlation between the number of graduates in an organisation and its innovative competence.

The importance is in the way resources are deployed, which allows the transformation from one resource into another. To obtain satisfactory evidence, the indicator metrics needs to be put in context: monetary value can, for example, be created through selling a process (organisational resources transformed into monetary resource) or new organisational Capital can be created through externalising tacit knowledge into a process (human resources transformed into organisational resources). Each organisation has to define for itself, what their equitable knowledge resources are; these should be treated and developed in sustainable manner. In addition, IC statements can be used to communicate knowledge management's objectives, initiatives and results to a number of target groups. Investors, for example, don't need to rely anymore on financial numbers only; they receive insight in the organisation's ability to survive future competition.

3. How does INTRATE-15649 work?

The reporting organisation receives a structural questionnaire and an interpretation help file. It is invited to respond to each of 58 requirements, whereby the statements shall consist of



three to four clear sentences. If an organisation can conclusively show, that a specific requirement has no relevance for them, the report evaluation will exclude this item for the scoring. The returned questionnaire will be

reviewed by a trained assessor. This review is based on a taxonomy, which benchmark refers to the optimal fulfilment of the requirements. For each of the Intangibles categories as well as for the IC management, medium values will be calculated and graphically shown in a bar diagram. The results will be verbally commented, what allows to correct disclosed gaps.

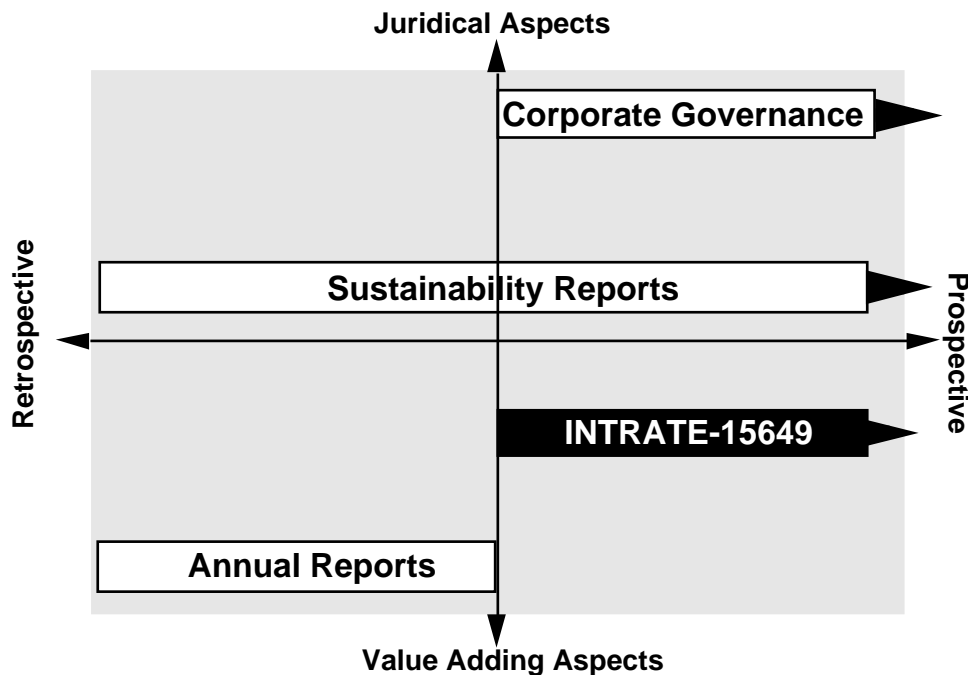
4. Applications of INTRATE-15649

There is an increasing interest by stakeholders (especially investment professionals) in disclosure of immaterial assets. Intangible like the one from the German BMW is a step forward in the right direction. However, it didn't receive the aspired acceptance, since it doesn't generate benchmark capability (*3). The other extreme is the *Intangibles Due Diligence* approach (*4), but this one is very time consuming and expensive. INTRATE-15649 follows a middle way offering a sufficient (harmonised) reporting form at moderate costs. Possible applications are shown below:

Applications	Target Groups	Benefits
Evaluating Creditability	Investors	Insight in Innovation Capability
Enterprise evaluation	Financial Analysts	Prospective info in the value adding chain
Sustainability-Ratings	Sustainability Funds	Including Intangibles in Audit
Sustainability Reports	Reporting organisations	Addendum for socio-economic criteria
Corporate Governance Ratings	Funds manager & Supervisors	Transparency about operational implementation
Succession processes	Enterprise Owner & -Buyer	Insight in survival investments
Internal Fitness-Check	Strategic Management	- Disclosure of sub-optimal Resource Processes - Internal Benchmarking
Accounting Standards	CFO's	Fulfilment Requirements of Basle II etc.
Recruiting	Potential Employees	Addendum to Company Information

5. Positioning of INTRATE-15649

INTRATE-15649-Reports are on one hand certificates about the future survival, which may strongly influence an investors decision. On the other hand they can be used to complete the conventional Corporate Communications (Annual reports, Sustainability reports & Corporate Governance) by offering prospective statements in the value adding chain:



Positioning INTRATE-15649 in Corporate Communications

6. SWOT Profile INTRATE-15649

Like every other evaluating tool, INTRATE-15649 contents strengths and weaknesses too, which need to be considered:

Strengths

Quick to apply at moderate costs	+ + + + +
Disclosure of obvious gaps	+ + + +
Long term consistent Benchmark	+ + +
All Intangibles in evaluation included	+ +

Weaknesses

Selfview may provoke false-positive results	- - - -
Subjectivity, when converting qualitative statements in qualitative figures	- - -
No long term experience yet	- - -
Assessor needs to have high IC skills; they cannot be learnt in a crash course	- -

7. Conclusion

It is undisputed that an efficient IC management generates and/or secures competitive advantages, which are hard to copy. Similarly, there is an increasing interest in Intangibles by stakeholders (especially by financial analysts). They are asking for a standardised IC benchmark tool. This produces a conflict of interest: *Secrecy of IC Data vs. Stakeholder Communication* and the challenge to set up a *standardised benchmark for different knowledge work*. This requires a conjoint measurement system that fulfils the demands of all concerned parties. The introduced tool INTRATE-15649 answers these challenges: An assessment serves to evaluate the prospective minded IC management, that doesn't look at the WHAT (resulting IC data); it looks at the HOW (documented processes and instruments). The aspired standardisation is reached at a high level by using a reference benchmark (Optimal fulfilment of the 58 requirements). The limitation of INTRATE-15649 is the information acquirement using a structural questionnaire that can produce false-positive results, which only can be justified by performing plausibility tests and/or spot checks at site.

8. Literature

All listed files are available from www.hrm-auer.ch/english_docs.php

- (*1) **Benchmarking Intellectual Capital?** / T. Auer / In Wissensmanagement 2004/04
- (*2) **Intellectual Capital and Investment Professionals: The View of the Users** / Speech Fritz H. Rau / Ferrara 2005
- (*3) **Intangibles Reports are a HIT but nobody looks after it!** / T. Auer / In Wissenschaftsmanagement 06/2005
- (*4) **Intangibles Due Diligence (IDD)** / T. Auer / Conceptual Working Paper 2006

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