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BALANCE SHEET OF THE NEXT MILLENNIUM – PERSPECTIVE, POSSIBILITIES AND PROBLEMS

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Abstract

'What gets measured gets managed.' Guided by this powerful performance improvement thought, this article tries to set up a framework for understanding the problems faced by organizations in measuring intangible assets. Very few organizations like Infosys have been valuing their intangible assets and have been publishing what may be called as the "balance sheet of the next millennium." Taking clue from this balance sheet this is an attempt to appreciate the importance of valuing intangible assets and also in understanding practical problems and possibilities associated with it.

Keywords: Balance Sheet, Intangible Assets, Measurement

Introduction

'What gets measured, gets managed.' This idea has been hailed as one of the brilliant ideas in the field of performance improvement, be it personal, professional or organizational. Despite great utility, unfortunately it has been observed, that measurement of intangible assets doesn't happen at all in most of the business organizations. It is indeed a paradox that while it has been accepted that human resources, for instance, are the most important asset for any business, there is hardly any attempt in practice to measure them. Why? What are the key issues that are acting as hindrances in translating this amazing theoretical concept of measurement into a practical application? This article intends to develop a framework for understanding these hindrances by way of a comprehensive study of the problems faced by organizations of different types– corporate, non-profit, small and medium enterprises, government organization etc, in measuring and reporting its intangible assets. It is felt that if practical solutions are worked out to these problems and a much awaited structural and a substantial change happens in the balance sheet of organizations, then there would be a change in the way intangible assets are perceived.

Those who are doing it

Public sector enterprises like Bharat Heavy Electronics Limited (BHEL), Steel Authority of India Limited (SAIL) and private sector IT companies like Infosys have taken lead in attempting their intangible asset valuation. Infosys, one of the leading IT company, has been publishing two balance sheets in its annual report since last 5 years. One is the conventional balance sheet that is prepared as per the prevailing Indian and International Accounting Standards and is audited. The second balance sheet that it prepares is a balance sheet which in addition to the tangible assets. It incorporates Human Resource Valuation and Brand Valuation in its innovative balance sheet and it gives an entirely different perspective towards looking at the company and its intangible assets because of a quantified value that is placed on these assets.

The following table presents a summary of the assets valuation of Infosys –

Rs. Crores

Year/Type of Asset	2009-10	2008-09	Average for 2 years
1. Tangible Assets as per conventional balance sheet	23281	18291	20786
2. Intangible assets as per “non-conventional” balance sheet	150194	134478	142336
3. Total assets (1 + 2)	173475	152769	163122
4. Percentage of 1 in 3	13%	12%	13%
5. Percentage of 2 in 3	87%	88%	87%
6. Number of times 2 of 1	6.5	7.4	6.8

Those who are not doing it

As of now, in India, there are exceptionally few organizations that are preparing their balance sheet including intangible assets. So a majority of the organizations are not doing it. But is it possible in the first place for organizations of all sorts to do it?

To illustrate this possibility, let us take the case of a MBA College. Are intangible assets the key to the success or failure of the College? There are no two answers. It is well accepted that intangible assets like human resources and brand are vital for the success of the college. But when we look at the balance sheet of the college, one would not find any reference whatsoever to the valuation of intangible assets. Why? When we ask this question to the Management of the College we get a typical answer – Balance Sheet being a subject matter of the Accountant, you can check with our Accountant. When we ask the Accountant, he in turn asks us, what are intangible assets? Or someone might say, all right, but where is the method? Still further, someone might say, we know there are methods, but those are meant for corporate and they cannot be applied to an educational institution. And that is the end of it.

If we try to analyze the problems in terms of hindrances coming in the way of intangible asset valuation for the above College, they can be broadly categorized into two –

a. Purpose related and
b. Process related

Purpose related problems are those that are basically concerned with the lack of appreciation of the need for valuation of intangible assets. Process related problems are those that are concerned with the technicalities and methods for the valuation. So is there a way to tackle both the problems? Yes. To convince the Management about the need for valuation, we can impress upon their minds the fact that the day is not far off when Foreign Universities would be coming to India and would be scouting to take-over some of the existing colleges. In that case, obviously, those with higher valuation would fetch a higher price. But if one sticks to the conventional valuation of the tangible assets alone, the college can get substantially undervalued. So it is important for the management to know the real and correct value of its college. Next the question comes as to how to go about the valuation of intangible assets like human resources for instance. This is also possible. The following paragraph demonstrates this.

Let's take the typical staff pattern –

Age	Professor		Associate Professor		Assistant Professor	
	Number	Average annual earnings (Rs.Lacs)	Number	Average annual earnings (Rs.Lacs)	Number	Average annual earnings (Rs.Lacs)
30-39	0	- -	1	7.00	10	4.00
40-49	2	10.00	1	8.00	2	5.00
50-54	0	- -	1	9.00	1	6.00

We can use the model developed by Lev and Schwartz to value the human resources of the College. Applying, the discounting factor of 15%, the present value of the earnings of the staff as taken in the table above works out to Rs.600.22 lacs or Rs.6 crores approximately. (Based on calculation for each category of the staff for the various age groups and for the tenure of the service in each age group.)

The above calculation is a rather simplistic one assuming the salary scales, number of staff and other such variables to remain constant. Sophistication involving changes in these variables for the sake of accuracy is possible.

When, we get this figure of Rs.6 crore worth of human resource valuation for a MBA college, then only actually the Management would get convinced that in the absence of this exercise it would have missed out on the value of a significant asset of the college.

However, having done the calculation and after arriving at the human resource value of Rs.6 crores on the basis of Lev and Schwartz Model, lets now examine the issue of cost of capital that has gone into the above calculation. We have taken here a discounting factor of 15%. Corporate uses its cost of capital as the discounting factor that is based on the popular formulae like the CAPM which is as under –

Expected Security Return = Risk free return + Beta x (Expected market risk premium)

Such an application is not possible for an educational institution unless it is a listed company. So, how are we going to determine the discounting factor (cost of capital) for an educational institution is a technical issue.

One simple solution is to take the cost of capital in terms of opportunity cost on the basis of the prevailing interest rates on term deposits of nationalized banks, that is, taking the risk free return as the opportunity cost of capital. Thus, we can settle for a cost of capital of say 10% based on the prevailing term-deposit rates.

From the above example, we can understand that, if we are convinced that there is a need to re-define our balance sheet in terms of inclusion of intangible asset valuation, we can do it. Of course, there are technical issues that need to be resolved like the one of cost of capital illustrated in the above example. But, there are solutions to these problems as well.

An analogy to highlight importance

We can draw an analogy with the concept of ISO 9000 and its practical implementation. When it was launched, the concept was adopted by only few organizations that too from the Corporate sector alone. However, today the situation is far different. One would come across organizations from a very broad spectrum having adopted ISO 9000. Small and medium enterprises, banks, other service organizations, private colleges, universities, government bodies like “Mahanagarpalika” and many more today are ISO 9000 organizations. And because of this we can see a visible impact in terms of improved quality. If measurement of intangible assets becomes a reality with large number of organizations, why there would not be a significant impact on improvement in the performance both in terms of efficiency and effectiveness?

Conclusion

So what is essentially required is a clearer and a better understanding of the problems that are preventing the change in the design of the balance sheet. And one really cannot afford to wait for the next millennium to arrive to bring about these changes to the balance sheet. It has to be done now but with some clarity on the issues involved so that appropriate practical solutions are worked out. And that is why it is felt that there is a need for an elaborate effort in studying this matter.

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