

Australian Guiding Principles on Extended Performance Management

A Guide to Better Managing, Measuring and Reporting
Knowledge Intensive Organisational Resources

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SOCIETY FOR KNOWLEDGE ECONOMICS

PRODUCTIVITY AND PERFORMANCE THROUGH KNOWLEDGE AND INNOVATION

Society for Knowledge Economics

These draft *Guiding Principles* have been prepared by Christina Boedker, on behalf of the *Society for Knowledge Economics*.

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Foreword

The global economy is increasingly connected and evolving towards service-based industries that thrive and survive only to the extent that they can learn, innovate and evolve with the needs of their customers and business partners. Organisations, regardless of sector, have obligations to better manage their knowledge intensive resources, - to innovate and be more sensitive to their stakeholders.

Ten years ago, businesses like eBay, MSN Hotmail, Google and Amazon were embryonic and beyond the comprehension of most people. However, today, these organisations have achieved scale and prominence that is phenomenal by any measure. More than ever before, people, organisations and the economies they shape are connected and services based. Resources such as knowledge, relationships and the capability to innovate are significant drivers of success.

The reality however is that many of the management and measurement tools we depend on to drive organisation performance are inadequate in this new environment. Managing a business, government agency or an economy requires new disciplines and measurement systems in this connected economy.

The role of the *Society for Knowledge Economics* is to provide best practices tools and guidelines, that address this need and by doing so make Australia a leader in driving productivity and performance through knowledge and innovation.

Steve Vamos

President, Society for Knowledge Economics

The arrival of the "Knowledge Economy" has been much heralded but what does this actually mean for organisations, government and the public at large?

Any attempt to improve the management and measurement practices of knowledge intensive organisations must first and foremost involve a deeper understanding of the characteristics of knowledge intensive resources.

The *Society for Knowledge Economics* has been founded to help advance the management, measurement and reporting of such resources. As an initial step, the *Society* is working on these *Australian Guiding Principles on Extended Performance Management* – a set of industry guidelines intended to inspire Australian organisations to better manage their knowledge intensive resources. We invite you to join us in testing and developing these draft *Guiding Principles*.

I would like to thank the Department of Finance and Administration (AGIMO) for supporting and endorsing the creation of the *Society*. I would also like to thank the *Society's* Committee of Management, our founding members, the Institute of Actuaries of Australia, CPA Australia and AGCCKC, as well as the many stakeholders who have helped us develop this early draft of the *Guiding Principles*.

One final and important point is that I would like to recognize and convey my appreciation to Christina Boedker for her outstanding work in preparing these draft *Guiding Principles*.

Mark Bezzina,

Executive Director, Society for Knowledge Economics

Background - Society for Knowledge Economics

This publication has been commissioned by the *Society for Knowledge Economics* (SKE). The *Society* was established in June 2005 following a mandate from the Australian Government Consultative Committee on Knowledge Capital (AGCCKC) and the Australian Government Information Management Office (AGIMO). At present, the *Society's* founding members include CPA Australia, the Institute of Actuaries of Australia, AGCCKC and Microsoft, Australia.

The objective of the *Society for Knowledge Economics* is to help improve organisational productivity and performance through the better management of knowledge and innovation.

The motivation to focus on the management of knowledge and innovation is driven by two macro-level drivers of change. One is the transition from the industrial economy (making tangible goods) to the service economy (delivering knowledge solutions), with a growing proportion of Australian GDP attributable to the effective management of knowledge intensive resources. The other is to address the well documented concerns regarding changing workforce demographics, with a large proportion of Australian knowledge workers scheduled for retirement over the forthcoming decades. Thus, increasing the productivity of a smaller work force is a critical national priority.

We believe these socio-economic transformations call for new business models, management skills and organisational practices, - practices, which maximise the productivity and performance of organisations' knowledge intensive resources, be they *relational, structural* or *human*.

The *Society for Knowledge Economics* aims to take a leadership role in advancing the development and uptake of best practices management principles in this growing field of practice. Among others, we aim to:

1. **Guiding Principles:** develop and test a series of guiding principles to enhance the management of knowledge and innovation within public, private and third sector organisations;
2. **Community of Practice:** establish and promote a community of practice to provide thought leadership consistent with the best practice guiding principles;
3. **Research:** prove through research the value, challenges and benefits associated with managing knowledge intensive resources;
4. **Professional Certification:** develop professional certification and high quality learning opportunities to improve the skills and competencies of the Australian workforce in the management of knowledge and innovation; and
5. **Partnerships:** partner with governments, professional associations, universities and public and private sector organisations to articulate and promote the value and benefits of the management of knowledge and innovation.

This publication is one in a series of planned publications intended to guide Australian organisations in the management of knowledge intensive resources. The publication is intended for the benefit of Australian organisations, the individuals that work for Australian organisations, the communities they affect and the national economy they seek to advance.

Mark Bezzina,
Executive Director, Society for Knowledge Economics

Executive Summary

Over the past century, organisations have witnessed major transformations in the economy within which they operate. The speed of doing business is faster than ever, technological progress is unprecedented and global economic growth has reached record highs.

Modern economists attribute such exceptional achievements to a fundamental transformation in the factors of economic production. It is the emergence of a “new economy”, in which conventional economic theory is challenged. Knowledge, with its increasing, not diminishing returns to scale, is changing business fundamentals and providing new opportunities for economic growth.

The Australian economy, which traditionally has sustained its wealth from natural resources and manufacturing, is no exception, with over 73 percent of its workforce employed in knowledge intensive services, contributing more than 52 percent to national GDP in 2003. Successful organisations operating in today’s knowledge economy increasingly derive their wealth from their knowledge intensive resources, be they *relational, structural or human*.

In the midst of this dynamic, fast moving environment remains one comforting pillar of stability. That is the 500-year-old accrual accounting system, which continues to be the foundation for measuring organisational success (and failure) in the 21st century. Traditional financial accounts provide a source of predictability and certainty; an assurance of life to continue “as is”.

However, during recent years, critics have started to question the adequacy of traditional financial accounts in a changed economy. They criticise financial accounts for their historical focus, failure to record important

intangible resources, and bias towards bottom line results, resulting in short-termism and opportunistic behaviour.

Critics are particularly concerned about the lack of recognition of the “new” factors of production on the balance sheet, - these invisible, so called intangible, knowledge intensive resources, which drive growth and competitive advantage to a larger extent than physical assets, remain largely unaccounted for. The International Financial Reporting Standard (IFRS) has done little to improve the situation, with the top 100 Australian organisations writing off \$7.5bn in intangible assets in 2005.

There is also a concern about the failure of the profit and loss statement to shed light on how organisations utilise and develop their knowledge intensive resources. Stakeholders, in particular investors, want information about the drivers of business value and how such drivers are managed, not merely the bottom line results of past performance.

To make up for the limitations of traditional financial accounts, modern practitioners and theorists have started to propose new ways in which to account for organisational performance. They talk about:

- Intellectual Capital Statements
- Corporate Social Responsibility Reports
- Balanced Scorecards
- Triple Bottom Lines

These “new accounts of performance”, which we call extended performance accounts, are encouraging signs for those concerned with sustaining organisational performance in a fast changing, global economy. They “make visible” the often overlooked, taken-for-granted knowledge intensive organisational resources, thus creating new opportunities for management intervention

and financial valuation. They provide a broader, more balanced, perspective on organisational wealth and shed light on the capacity an organisation has to create value in the future. Some even argue that these new performance accounts are paving the way for a fundamental rethink of the way in which organisational performance is thought of, and accounted for.

A central, yet unanswered, question in the debate on extending traditional management and financial accounting practices, however, relates to the gains and benefits that accrue to organisations from doing so.

Sceptics are quick to point out the weaknesses of extended performance accounts, highlighting the competitive disadvantage resulting from greater transparency; the lack of validity, accuracy and objectivity of extended performance information; the incomparability of such information across organisations, industries and time; and the resource requirements and complexity associated with tracing the value that accrues from investing in knowledge intensive resources.

There is no single uniform answer with which to counter these concerns, and evidence thus far is inconclusive. However, trends are starting to emerge substantiating the benefits that flow to organisations that measure and report the value of their knowledge intensive resources.

A recent study by KPMG, which investigated the management practices of 1600 of the largest companies around the world, found that organisations produce extended performance accounts to reduce risk exposure, improve employee motivation and enhance workplace innovation.

These objectives were confirmed, to varying degrees, by the 150 Danish organisations, who participated in the preparation of intellectual capital statements over a five-

year-period. Many of these organisations reported heightened levels of employee motivation, a larger pool of candidates to recruit from, a greater capacity for customer retention, and improved employee awareness of organisational activity, strategy and objectives.

In the US, statistical analysis of extended performance information supports these findings and shows a correlation between employee attitudes, customer satisfaction and financial performance, thus confirming, as one would expect, that investments into knowledge intensive resources increase financial returns.

In the capital market arena, research shows that extended performance accounts can positively affect share price. Markets reward, and increasingly expect, organisations to increase transparency. Transparency, in turn, reduces uncertainty, thus resulting in lower risk premiums and more accurate company valuations.

At the heart of this search for business evidence substantiating investment decisions however lies a number of critical questions. These pertain, among others, to reflecting on what constitutes good corporate performance management, measurement and reporting in the 21st century. Is the pursuit of quantifiable representations of business performance and reliance on financial data the best means of organisational performance (e)valuation? If not, what type of performance indicators do we assign to measure the success (and failure) of knowledge intensive organisations in the 21st century? How do we best identify and value knowledge intensive resources given their subjective, invisible and often value-laden character? And within which structure and with what means (narratives, images or numbers) do we best report on their performance?

These *Australian Guiding Principles on Extended Performance Management* (EPM) attempt to answer

some of these questions. We provide insights into the structure and content of contemporary EPM frameworks, highlighting how they differ from traditional financial accounts. We also propose a framework and a series of management steps intended to help organisations produce extended performance accounts and, as a result, develop new understandings of the value that accrues from their knowledge intensive resources.

Besides professional bodies and public, private and third sector organisations, we appeal to Australian government officials and public policy makers interested in staying in tune with national and international trends and developments in this field. We provide insights into international trends such as the Danish and Japanese guidelines on intellectual capital and intellectual property measurement and reporting; the UK Operating and Financial Review (OFR), which now requires organisations to publicly disclose information about their knowledge intensive resources; Austrian legislation, which requires certain public sector organisations to produce intellectual capital reports; and the United Nation’s Global Reporting Initiative (GRI), which sets a benchmark for international standards in social, economic and environmental reporting. We raise questions as to what is the role and contribution of Australia to these developments and how can we best position and promote Australia as a leading knowledge economy within the international community?

We invite readers to work with us in advancing the position of Australia as a knowledge economy. And we are particularly interested in extending an invitation to public and private sector organisations to participate in testing the *Guiding Principles on Extended Performance Management*.

1. Scope and General

1.1. Motivation and Scope

Traditional accounts of organisational performance have often been criticised for their failure to illustrate the value of intangible, knowledge intensive organisational resources. These *Australian Guiding Principles* respond to this criticism and introduce the concepts “extended performance management” and “extended performance accounts”.

Extended performance accounts differ from traditional financial accounts by “making visible” an organisation’s knowledge intensive resources not recorded and accounted for in traditional financial statements. In doing so, they provide managers and others with new insights into organisational performance and open up new opportunities for management intervention and financial valuation.

An extended performance account complements the three existing financial accounts. Some even refer to it as the “fourth” account of organisational performance.

In brief, extended performance accounts are:

- **strategic in nature**, placing knowledge intensive resources within the strategic business context in which they rightfully belong;
- **forward looking**, providing insights into how an organisation is positioned to create value across different time horizons; and
- **often simple in structure**, providing a one-page snapshot of the organisation’s knowledge intensive resources and activities.

Extended performance accounts can be used for different purposes, depending on an organisation’s

specific needs, requirements and circumstances. Some organisations use the account for **internal management purposes**, as a tool to provide managers and others with new insights into the value and performance of the organisation’s knowledge intensive resources. Extended performance accounts have also been used as brainstorming and planning tools to improve the effectiveness of resource allocation and strategy formulation; as change management tools to transform workplace culture; and as motivational devices to improve employee productivity and stakeholder awareness of organisational identity, activity and intent.

Some organisations also choose to use their extended performance account for **external reporting purposes**. The objective here is to aid the decision making processes of stakeholders, such as potential employees, investors customers and others, by disclosing information about the organisation’s knowledge intensive resources, not recorded and accounted for in traditional financial accounts.

We provide illustrations of such usages in our two mini case studies with the NSW Department of Lands and Westpac Banking Corporation.

We learn from these “early innovators” that extended performance accounts must be embedded into management thinking and reflect managerial activities and courses of action. An extended performance account is not a disengaged corporate report, driven by regulatory requirements. It is neither a marketing collateral striving to gain public acceptance. It is instead a dynamic account, which helps organisations reflect on their “identity”, their “DNA”, and start a journey in which Purpose (i.e. “where they we going?”) and Means (“how do we intent to get there”) are centered around the strategic management of knowledge intensive organisational resources.

We propose a framework and series of management steps to guide organisations interested in preparing an extended performance account. We use the label *extended performance management* (EPM) to signify the management processes organisations are likely to go through as they prepare the account.

In brief, we find that EPM can help organisations:

- take a broader perspective on the drivers of organisational performance and focus their attention on the often invisible and taken-for-granted knowledge intensive organisational resources, be they *relational, structural or human*;
- engage in a process of reflection and innovation in which managers gain new ideas, inspirations and perspectives on business management;
- create an infrastructure, which allows for, and encourages, reciprocal communication flows between the organisation and its key stakeholder groups; and
- reflect on their efforts in creating a sustainable organisation taking into consideration the external impacts and contributions of organisational activity, be they social, environmental or ethical;

Our pilot projects tell us that by placing at the centre of attention the often taken-for-granted knowledge intensive resources, EPM opens up new opportunities for organisational value creation. Possible the main benefit is an improved capacity among managers and leaders to reflect on how they manage, utilise and develop knowledge and innovation. It is the acknowledgement that knowledge and innovation, despite their intangible character, needs to be explicitly managed, and developed within a strategic context. The value thus lies in an enhanced capacity among

managers to conceptualise the role, functioning and effects of managing knowledge and innovation. We refer to this as “making visible the invisible”.

Other benefits that may flow to organisations who engage in EPM include, but are not limited to:

- improved financial performance and sustainable organisational health;
- improved stakeholder relations and increased awareness of stakeholder needs and perspectives;
- a stronger reputation and corporate image;
- a greater capacity for customer acquisition and retention;
- better information to inform resource allocation and strategy formulation;
- reduced risk exposure due to improved employee awareness of organisational activities, objectives and strategy;
- a greater capacity for innovation, learning and development;
- heightened levels of employee motivation and trust; and
- a lower cost of capital and improved share price valuation.

However, a number of challenges may also lie await for organisations that embark on the journey of producing an extended performance account. These may include, but are not necessarily limited, to:

- attracting resources;
- developing and sustaining interest and commitment from executives, employees and others;
- attracting (visionary) teams leaders;
- determining levels of responsibility and accountability;
- project planning;
- overcoming employee resistance and challenging the status quo; and
- identifying and tracking the value and performance of knowledge intensive resources.

1.2. Objectives

The objectives of these *Australian Guiding Principles* are four-fold:

1. to raise public awareness of how to strategically manage knowledge intensive organisational resources and activities;
2. to propose and initiate the testing of a framework and series of management steps to assist Australian organisations to better understand the value and performance of their knowledge intensive resources;
3. to help place Australia on the map as a leader in the management and development of workplace knowledge and innovation; and advance the testing, and uptake of best practice in this emerging field of

management; and

4. to increase awareness among users of organisational performance information, be they employees, customers, shareholders or others.

1.3. Readers and Target Audience

These *Australian Guiding Principles* are intended for, but not limited to, the following audiences:

- Australian public, private and third sector organisations seeking to engage in the preparation of extended performance accounts;
- government officials wishing to become familiar with the latest trends and developments in extended performance management, internationally and in Australia; and
- investors, professional bodies and other community groups seeking to increase their understanding of the structure, content and effects of extended performance accounts.

1.4. Structure and Content

These *Australian Guiding Principles* are structured accordingly.

Section 2 defines the terminologies used in the *Guiding Principles*.

Section 3 contextualises extended performance management and provides an overview of the macro-level drivers of change, outlining the transformations in the national economy and the factors of economic production.

Section 4 provides a comparative analysis of existing frameworks for managing, measuring and reporting knowledge intensive resource and activities. We compare extended performance accounts with traditional financial accounts, highlighting the differences in reporting categories between the two types of organisational performance accounts. We conclude with a brief review of some of the work place and financial effects documented thus far, illustrating the benefits that may flow to organisations that measure and report the value of their knowledge intensive resources.

Section 5 proposes a framework for developing an extended performance account. The framework is simple in structure, strategic in nature and future oriented. We also provide practical examples of extended performance accounts produced by Australian organisations during early stage pilot projects.

Section 6 proposes a series of management steps intended to help Australian organisations create an extended performance account and in doing so, facilitate a strategic approach to the management of knowledge and innovation.

Section 7 concludes the *Guiding Principles* with a review of national and international trends and developments in legislation, guidelines, codes of conducts and standards. We also review some of the challenges facing organisations and information users in advancing extended performance management, and point towards a series of action points to help pave the way forward.

2. Definitions of Terms

Practitioners, public policy makers and researchers alike are faced with a plethora of definitions and terminologies to make sense of when discussing the resources and characteristics of the knowledge economy. We hear talk of intangible assets, intellectual resources, knowledge based assets, knowledge capital, intellectual capital and intangible resources.

The purpose of this section of the *Guiding Principles* is to reduce the level of ambiguity surrounding this plethora of terminologies. We aspire to influence the development of a common language and propose a series of definitions to inform our discussions.

1. **Accountability**

Accountability refers to the adoption of sustainable business management, measurement and reporting practices, which seek to reduce the negative impacts and enhance the positive impacts of organisational activity, be they societal, environmental, ethical or economic.

2. **Accounting**

Accounting refers to the systematic identification, analysis, recording and reporting of information about organisational resources, activities, performance and impacts.

3. **Accounting Information**

Accounting information comprises financial and non-financial performance information. The purpose of accounting information is to enable internal and external stakeholder to make informed decisions about the organisational performance.

4. **Accounting System**

An accounting system records information about an organisation’s activities, resources, impacts and performance. It comprises systematic processes and repositories, which allow for the collection, storage and dissemination of organisational performance information.

5. **Asset**

An asset is a resource that is controlled by the enterprise as a result of past events (for example, purchase or self-creation) and from which future economic benefits (inflows of cash or other assets) are expected (International Financial Reporting Standard (IFRS)).

6. **Extended Performance Accounts**

Extended performance accounts differ from traditional financial accounts of organisational performance by placing knowledge intensive resources and activities at the centre of attention. They “make visible” the often overlooked, taken-for-granted intangible resources, be they *relational, structural or human*.

Extended performance accounts are:

- **strategic in nature**, placing knowledge intensive resources within the strategic business context in which they rightfully belong;
- **forward looking**, providing insights into how an organisation is positioned to create value across different time horizons; and

- **often simple in structure**, providing a one-page snapshot of the organisation’s knowledge intensive resources and activities.

7. Extended Performance Management (EMP)

The objective of EPM is to help organisations prosper by providing them with the tools, ideas and philosophies for better managing their knowledge intensive resources, be they *relational, structural* or *human*. EMP entails:

- adopting a more strategic and complete approach to managing knowledge intensive resources and activities;
- establishing reciprocal communication flows between the organisation and the groups of individuals it seeks to create value for, thus taking into account the value perspectives and needs of key organisational stakeholder groups; and
- taking into account the external impacts of organisational activity, be they social, environmental or ethical, thus creating better conditions for sustained organisational and community performance.

Operationalising EPM may be informed by the proposed management steps outlined in section 6 of these *Guiding Principles*.

One outcome of EPM is an extended performance account, as exemplified in the mini case studies of the NSW Department of Lands and Westpac Banking Corporation in section 5.2.

8. Extended Performance Management Frameworks

Extended performance management frameworks are used to manage knowledge intensive organisational resources in a balanced and strategic manner. They help visualise and measure the value and performance of knowledge intensive organisational resources and activities. Examples include, but are not limited to, the Balanced Scorecard, the Scandia Navigator, the Intangible Asset Monitor, the ValueReporting™ framework, the Intellectual Capital Statement model and the framework proposed by the United Nation’s Global Reporting Initiative.

9. Extended Performance Measures

Extended performance measures are organisational performance measures, which are not derived from the three financial statements: the balance sheet, the profit and loss statement and the cash flow statement.

Extended performance measures complement financial measures to provide a broader, more balanced perspective on organisational health and future prospects. They:

- help identify, measure and illustrate the value that accrues from knowledge intensive organisational resources and activities. Examples include, but are not limited to, employee morale, community relations, employees’ innovative capacity etc;
- include lagging and leading indicators, of which the latter provide insights into how an organisation is positioned to create

value now and in the future; and

- illustrate the managerial activities and efforts which go into the value creation process, not solely the financial outcomes of organisational activity.

10. Financial Resources

Financial resources refer to an organisation’s financial capital and profile. They include, but are not limited to, an organisation’s liquidity, borrowing capacity, credit rating, working capital, depreciation policy, risk profile, revenues, expenses, profit margin, tax rate, cash flows from operating, investing and financing activities, weighted average cost of capital, \$-value of assets (cash reserves, receivable balance, provisions, inventory balance), \$-value of liabilities (loans, accounts payable, unearned revenue), and shareholder equity.

11. Intangible Asset

The terminology “intangible asset” is derived from accrual accounting. According to the IFRS, an intangible asset is defined as an identifiable non-monetary asset without physical substance. To be recognised on the balance sheet, an intangible asset must be identifiable, controllable, reliably measurable and provide future economic benefits (such as revenues or reduced future costs).

An intangible asset is identifiable when it:

- is separable (capable of being separated and sold, transferred, licensed, rented, or exchanged, either individually or as part of a package); or

- arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

The IFRS requires that:

- research, start up, internally generated goodwill, training, relocation and advertising costs are expensed;
- internally generated intangible assets (e.g. mast heads, brand names etc that arise other than by way of acquisition) are not recognised as assets and must also be expensed;
- intangible assets are subject to amortisation and impairment testing; and
- intangibles are only re-valued if there is an active market for the asset.

Intangible assets may be categorised as:

- marketing related: trademarks, brands, trade names, trade dress, internet domain names, newspaper mastheads, non-competing agreements;
- customer related: customer lists, order or production backlog, customer contracts;
- artistic related: plays, operas, ballets, books, magazines, newspapers, musical works, pictures, photographs, videos, films, television programmes;
- contract based: licensing, royalty and standstill agreements, contracts for

advertising, construction, management, service or supply, lease agreements, construction permits, franchise agreements, operating and broadcasting rights, use rights such as drilling, water, air, mineral, timber cutting and route authorities, servicing contracts, employment contracts; and

- technology based: patented technology, computer software, unpatented technology, databases, and trade secrets.

12. Information Management

Information management describes the means by which an organisation efficiently plans, collects, organises, uses, controls, disseminates and disposes of its information, and through which it ensures that the value of that information is identified and exploited.

13. Intellectual Capital

Intellectual capital is the organisational perspective (or worldview) that is adopted to identify and address the management of an organisation’s knowledge intensive resources. It pertains to making visible the often taken-for-granted knowledge intensive organisational resources, not recorded and accounted for in the traditional financial statements.

14. Knowledge

Knowledge is two dimensional, being either explicit or tacit.

- **Explicit knowledge** can be documented and codified in the form of manuals and

operating procedures.

- **Tacit knowledge** is personal and context-specific. It exists in people’s heads and is described as being accumulated, experiential and represented in a person’s skills and competence. It is hard to formalise and communicate.

15. Knowledge Intensive Resource

A knowledge intensive resource exists in two forms:

- **An explicit knowledge intensive resource** comprises a tangible element (such as a computer) and a knowledge element (such as the know-how of how to start the computer). The two co-exist. The tangible resource is made operational when knowledge is applied to it, and vice versa. Examples include software, information technology, customer relations, distribution channels etc.
- **A tacit knowledge intensive resource** has no substance. It exists on its own without the intervention of tangible resources. It is enacted through action, conversation, and human interaction. Examples include culture, norms, behaviour, rituals, routines, problem solving skills and others.

Knowledge intensive resources are classified into a tripartite scheme as follows:

- **Structural (Internal) Capital** includes, but is not limited to, corporate culture, management philosophy, organisational

structure, management processes, information systems and networks, intellectual property, contracts, research and development and new product development.

- **Relational (External) Capital** includes, but is not limited to, corporate name and brands, alliances and partnerships, licensing and franchising agreements, supplier and distribution channels and relations, community relations, government relations, industrial relations, customer relations, and financial relations.
- **Human Capital** includes, but is not limited to, employee demographics, employees’ innovative capacity, employee diversity, learning and development abilities, educational and work-related qualifications, leadership and top management quality.

Knowledge intensive resources are likely to possess the following characteristics. They are:

- not easily identifiable or readily visible and therefore often taken-for-granted and overlooked;
- not easily controllable or separable from the owner or object, and thus more risky to invest in than tangible assets;
- often a source of organisational competitive advantage and core competency;
- often unique and company specific, and therefore difficult to compare across

organisations; and

- often subjective, qualitative and value-laden and thus more complex to quantify and value in \$-terms.

Contrary to physical assets, which decrease in value when used, knowledge is cumulative. The more knowledge is used and shared, the more new knowledge is generated. Knowledge intensive resources thus provide increasing returns to scale¹.

An example includes the knowledge developed by a management consulting team as they solve a client problem. In the process of solving the task, the team leverages their existing knowledge. They however also build new knowledge, which they subsequently share with the client organisation and subsequent clients to whom they consult. The more the team utilises and shares their knowledge, the more the team learns, and the more the client(s) learns.

Another example includes joint product development whereby organisations include suppliers, customers and other key stakeholders in the product development process. In the process of jointly designing the product, the parties share knowledge and learn from each other. In the process, they each develop new knowledge.

Thus, the more we utilise and share knowledge, the more we learn and the more new knowledge we develop. Knowledge is

¹ See endogenous growth theory (e.g. Romer, 1986, Romer, 1990 and Gylfason, 1999)

therefore cumulative, and provides increasing returns to scale.

16. Knowledge Management

Knowledge management refers to the management of the organisation’s knowledge intensive resources, be they *relational, structural* or *human*.

Knowledge management is not to be mistaken for information management. Information is codifiable knowledge and thus information management concerns the management of codifiable knowledge. Examples may include an organisation’s standard operating procedure, user manuals and customer lists.

Knowledge, in contrast, exists in the form of tacit knowledge (see definition above). An example of tacit knowledge includes the innovative capacity of a member of staff. Here, tacit knowledge is seen to exist in people’s heads and has proven difficult to codify. Case studies of attempts to codify tacit knowledge often show that the value of tacit knowledge is lost as managers try to capture, codify and control it (i.e. you cannot capture an employee’s innovative capacity; at best you can ensure it prospers and is allowed to flourish).

17. Management

Management comprises six reiterative, un-sequential processes:

1. Identification
2. Analysis
3. Action planning and strategy formulation
4. Implementation
5. Measurement

6. Reporting

18. Market Analysis

Market analysis comprises an analysis of the macro-environmental and industry specific factors which impact the organisation and its value creation activities and abilities. These are classified into seven categories:

1. Competitors
2. Political Factors
3. Economic Factors
4. Societal Factors
5. Technological Factors
6. Environmental Factors
7. Legal Factors

19. Organisational Resources

Organisational resources are classified into three broad categories:

- Financial resources
- Physical resources
- Knowledge intensive resources.

20. Physical Resources

Physical resources refer to tangible resources such as plant, property, equipment and inventory.

21. Reporting

Reporting refers to the documentation of information. Reporting may be used for internal management purposes or for external disclosure purposes. External reporting may be voluntary or driven by legislative reporting requirements.

22. Resource Analysis

Resource analysis refers to the identification and analysis of an organisation’s resources. For the purpose of these *Guiding Principles*, we focus on the analysis of knowledge intensive organisational resources. The objective of resource analysis is to provide an inventory of the knowledge intensive resources the organisation has at its disposal.

Examples include, but are not limited to: number of employees; number of customers; type of customer; number of strategic alliances and partnerships.

23. Resource Management Analysis

Resource management analysis comprises an analysis of the activities undertaken to manage the organisation’s knowledge intensive resources relative to its strategic objectives. Resource management activities are classified into five broad categories:

1. Acquisition of knowledge intensive
2. Development of knowledge intensive
3. Utilisation of knowledge intensive
4. Maintenance of knowledge intensive
5. Disposal of knowledge intensive

24. Stakeholders

Stakeholders include all persons, or groups of people, external or internal to the organisation, who affect, or are affected by, the organisation’s operating activities. External stakeholders include, but are not limited to:

- Capital Market Actors
- Community
- Customers

- Distributors
- Suppliers
- Government
- Education Providers
- Non-government Organisations.

Internal stakeholders include, but are not limited to:

- Board Members
- Consultants
- Contractors
- Employees such as Senior Executives, Managers and Staff.

25. Stakeholder Analysis

Stakeholder analysis refers to the identification and analysis of the expectations, perspectives and needs of internal and external organisational stakeholders. It helps managers better understand their organisations by facilitating reciprocal, as opposed to one way, communication flows between organisations and the people they serve and affect. Stakeholder analysis may be facilitated through interviews, surveys, focus groups or other means of stakeholder engagement and feedback.

26. Sustainability

Sustainability refers to the adoption of business practices, which prioritise long-term survival and value creation. It comes from the verb to sustain, which means to hold up; to support; to maintain; to keep going; to prolong; to support the life of. By paying attention to sustainability, organisations can confront and adjust over time those activities that may provide both short term financial returns and ensure long term business health.

The 1987 Brundtland report noted that sustainable development is “to meet the needs of the present without compromising the ability of future generations to meet their own needs”.

3. Drivers of Change – Economic Transformations

Traditional financial performance accounts have for long been criticised for not recognising critical intangible, knowledge intensive resources. In this introductory section of the *Australian Guiding Principles*, we seek to contextualise this critique and provide an overview of the macro-level drivers of change. We introduce the notion of the knowledge economy, highlighting the changes in the structure of the Australian economy over the past centuries and the transformations in the factors of production (Table 1).

Table 1: Economic Transformations

	Economic Activity	Factors of Production
Agricultural Economy Pre-1800	Harvesting	<ul style="list-style-type: none"> ▪ Land ▪ Land owners and workers
Industrial Economy 18th to 20 th century	Manufacturing	<ul style="list-style-type: none"> ▪ Labour ▪ Machinery ▪ Raw material
Knowledge Economy 20 th century and onwards	Mediation of Knowledge and Services	<ul style="list-style-type: none"> ▪ Relational capital ▪ Structural capital ▪ Human capital

3.1. The Rise of the Knowledge Economy

The past century has witnessed major transformations in the structure of the Western economy. These transformations have been driven by the growth in service-based industries in which knowledge intensive resources constitute the main part of the value creation process. Today, service-based industries comprise over 68 percent of world GDP, up from 61 percent in 1990. Goods producing industries contribute 28 percent, down

from 34 percent in 1990; and agriculture contributes 4 percent, down from 5 percent in 1990.

The contribution of service-based industries to Australian GDP is slightly lower than global averages, given the continued reliance on natural resources and manufacturing in Australia. The 2005 Yearbook *100 years of Change in Australian Industry* by the Australian Bureau of Statistics shows that:

- services contributed almost half (48.4 percent) to GDP in 2000-01, up from 31 percent in 1900-01;
- government administration increased its contribution to 4.1 percent in 2000-01, slightly higher than in 1900-01 and 1950-51;
- manufacturing, the next largest industry, contributed 11.9 percent, slightly less than its 12.2 percent contribution in 1900-01, but half of its contribution of 22.4 percent in 1950-51, reflecting the increase in development of manufacturing during World War II;
- dwelling rent contributed 9.8 percent to GDP, only slightly less than its contribution in 1900-01, but almost four times as much as its contribution 1951;
- both the mining and construction industries contributed 5.6 percent in 2000-01. Mining's share had more than doubled since 1950-51, but was still only around half its share of GDP in 1900-01; and
- agriculture, the largest individual industry in 1900-01, contributing 19.4 percent to GDP, was only 3.7 percent in 2000-01.

The growth in service based industries is also reflected in the changes in employment data with over 73 percent of the Australian workforce employed in services in 2000 (Table 2). The four main employment sectors at

the turn of the century included: Retail Trade; Property and Business Services; Health and Community Services; and Education.

The greatest increase from 1995 to 2000 occurred in Property and Business Services (31.9 percent), followed by Construction (17.9 percent), and Personal and Other Services (16 percent). The greatest decrease occurred in Electricity, Gas and Water (24.4 percent).

Table 2: Australian Employment Trends

	1994-95(a)	1999-2000(a)	Increase
	'000 persons	'000 persons	
Goods Producing Industries -			
- Agriculture	403.3	437.5	8.5
- Mining	86.1	78.2	-9.2
- Manufacturing	1,115.3	1,113.1	-0.2
- Electricity, Gas and Water	86.8	64.5	-25.6
- Construction	589.8	695.4	17.9
- Total	2,281.3	2,388.7	4.7
Service industries -			
- Wholesale Trade	493.6	494.9	0.3
- Retail Trade	1,187.0	1,324.6	11.6
- Accommodation, Cafes and Restaurants	377.2	432.8	14.7
- Transport and Storage	381.4	407.3	6.8
- Communication Services	148.4	169.3	14.1
- Finance and Insurance	312.9	327.5	4.7
- Property and Business Services	749.8	988.7	31.9
- Government Administration and Defence	357.3	345.8	-3.2
- Education	555.6	609.3	9.7
- Health and Community Services	720.2	828.1	15.0
- Cultural and Recreational Services	189.2	217.1	14.7
- Personal and Other Services	303.7	352.3	16.0
- Total	5,776.2	6,497.8	12.5
Total All Industries	8,057.4	8,886.5	10.3
Service Industries as a Percentage of All Industries	71.7	73.1	

3.2. Knowledge Intensive Resources Are the “New” Factors of Production

The emergence of a knowledge intensive economy has implications for the factors of economic production. Many organisations and national economies today derive their competitive advantage from their intangible, knowledge intensive resources, be they *relational*, *structural* or *human*. Managing relationships, business structures and processes, and human capital is critical to organisational wealth and health in the knowledge era.

A core driver of change is the emergence of new technologies and the creation of “virtual” relationships and instant “knowledge exchanges”. In 1994, Australia had one million mobile phones and almost no homes connected to the internet. Today, there are twenty million mobile devices in the market and millions of homes connected to the internet. Such new technologies enable knowledge to be exchanged, shared and traded across national and organisational boundaries, in ways thought impossible two decades ago.

The proliferation of “virtuality” and “interconnectivity” has implications for the nature and structure of contemporary business models. We see the traditional value chain, in which tangible resources dominated, being replaced by value shops and value networks, in which problem solving (i.e. consulting firms) and mediation of exchanges (i.e. eBay) comprise the new factors of production. The notion of a connected, knowledge intensive and innovation based economy is developing rapidly before our eyes.

A 2003 survey conducted by Accenture with senior executives from twenty-seven countries and nineteen industries supports the notion of a globally connected

knowledge economy in which intangible knowledge intensive resources dominate wealth creation. The survey finds that 49 percent of executives believe intangible resource are the most important sources of shareholder wealth creation; 26 percent find tangible and intangible resources to be of roughly equal importance; and only 25 percent of executives find that they rely primarily on tangible assets for shareholder wealth creation.

A recent survey by McKinsey (2005) supports the above findings and illustrates the changing information needs of senior executives. It shows that company directors are looking for more information about organisations’ intangible, knowledge intensive resources. In order of importance, the 1016 company directors surveyed wanted to know more about the following areas: 1) Market Health (customer profitability/satisfaction, competitors’ market share and products, suppliers, brands); 2) Organisational Health (employee retention/satisfaction, capabilities and skills, organisational structure, culture, values); 3) Network Health (regulatory changes, government policies, public opinion, community views); 4) Financial Performance (cash, costs, EBITDA, margins, return on capital); and Operational Health (buildings, inventories, patents, product pipeline, production rates). The survey concludes that directors sometimes lack the information needed to make sound decision making. This compromises their ability to fully understand the objectives and risks of their companies.

However, despite this consensus of the growing importance of intangible, knowledge intensive resources, there is limited agreement among practitioners, professionals, policy makers and researchers as to how to define, measure and report these “invisible” resources. Professional accounting standards have taken a conservative stance and

restricted the recognition of intangible resources to those which are identifiable, reliably measurable, controllable, and acquired from external parties, thereby excluding a wide range of important knowledge intensive resources. The result today is a continued focus on tangible resources, bottom line results and prioritisation of short term financial performance setting aside the qualitative, intangible aspects of organisational health and wealth.

These *Guiding Principles* aspire to broaden existing perspectives on corporate performance management, measurement and reporting, and increase awareness of the issues surrounding intangible, knowledge intensive resources.

The first step we take towards realising this objective is to provide a broader classification of intangible, knowledge intensive resources (Figure 1), thus encouraging recognition which extends beyond traditional financial accounting standards. Our classification scheme comprises **structural capital** (the structures and processes employees develop and deploy in order to be productive, effective and innovative); **relational capital** (the organisation’s relationships with external stakeholders be they suppliers, customers or others); and **human capital** (the skills, attitudes, abilities, competencies and qualities of the organisation’s employees).

We acknowledge the inherent difficulties associated with identifying, controlling and reliably measuring these ‘invisible’ resources. We also acknowledge that these resources have very different characteristics to the traditional tangible resources. Thus, we emphasise

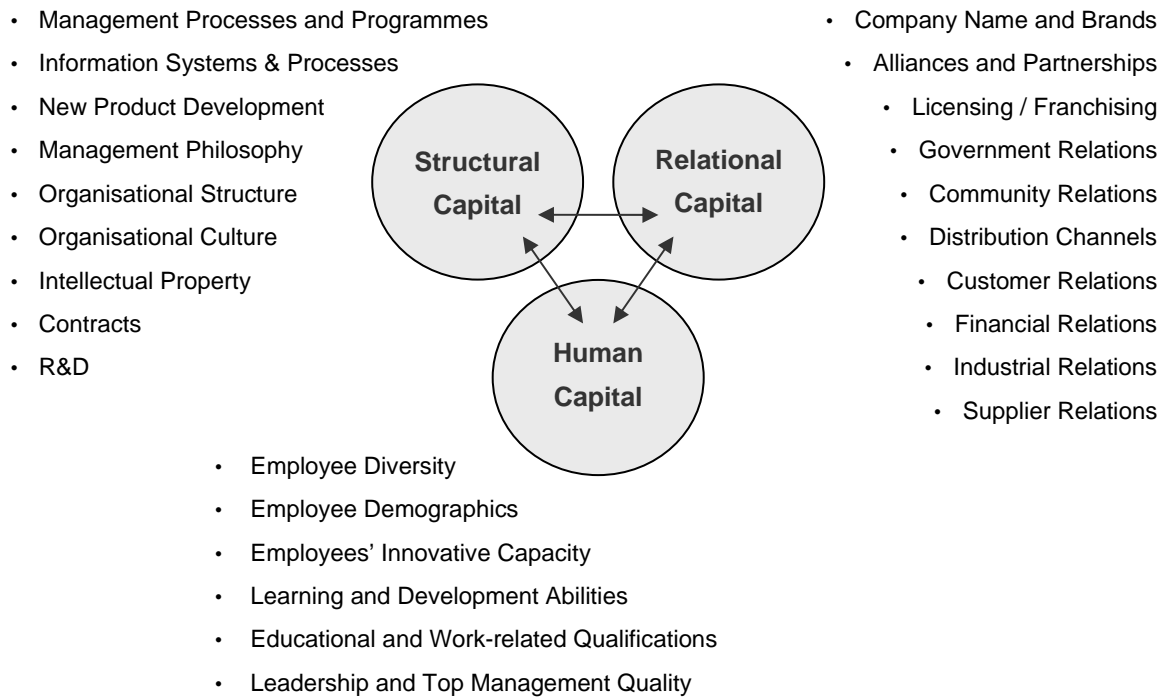
that for business managers to better manage and derive value from knowledge intensive resources they need to first develop an appreciation of the characteristics of such resources and how they differ to the conventional, tangible factors of economic production.

In brief, intangible, knowledge intensive resources are:

- not easily identifiable or readily visible, and therefore often taken-for-granted and overlooked;
- not easily controllable or separable from the owner or object, and thus more risky to invest in than tangible assets;
- often subjective, qualitative and value-laden and thus more complex to quantify and value in \$-terms;
- often a source of organisational competitive advantage and core competency; and
- often unique and company specific, and therefore difficult to compare across organisations.

The second step towards raising awareness of the issues surrounding the management, measurement and reporting of knowledge intensive resources is to review existing frameworks for “visualising” such resources. We label these extended performance management frameworks (see section 4).

Figure 1: Knowledge Intensive Resources



4. Overview of Extended Performance Management

The previous section introduced a classification scheme for conceptualising and categorising knowledge intensive resources (Figure 1). It also alluded to the limitations of professional accounting standards in recognising the value of such resources. In this section of the *Guiding Principles*, we examine contemporary responses to this critique and introduce the concepts of extended performance management (EPM) and extended performance accounts.

We start by providing a comparative summary of existing frameworks, which extend the traditional approach to measuring and accounting for organisational performance. We then compare the reporting categories of traditional financial accounts with those of extended performance accounts. This is followed by an examination of the type of performance measures commonly reported in extended performance accounts. We conclude with a brief review of empirical evidence developed by researchers thus far to illustrate the benefits that may flow to organisations who embrace the agenda of EPM.

4.1. Extended Performance Management Frameworks

The conservative stance of professional accounting bodies in the intangible discourse has given rise to a growing criticism of traditional financial accounts and performance measures. Critics claim that the stocks of tangible resources recorded on the balance sheet and the \$-outcome measures shown on the profit and loss statement, however useful, no longer fulfil the information needs of organisational stakeholders, be they managers, investors, employees, governments, customers, suppliers or others. Financial performance

measures inform only one part of the overall “picture” required to evaluate organisational performance. Critics are particularly concerned about the lack of recognition of the “new” factors of production on the balance sheet, with many intangibles being expensed, not capitalised, thus acting as a potential disincentive to investing into *relational*, *structural* and *human capital*. The new International Financial Reporting Standard has done little to rectify the situation, with the top 100 Australian organisations writing off \$7.5bn in intangible assets in 2005.

Critics are also concerned about the failure of the profit and loss statement to shed light on *how* organisations utilise and develop their intangible, knowledge intensive resources. Simple question such as “to what extent do organisations realise the full potential of their *relational*, *structural* or *human capital*?” and “what actions to they take to maximise the utilisation and development of such resources?” currently goes unanswered.

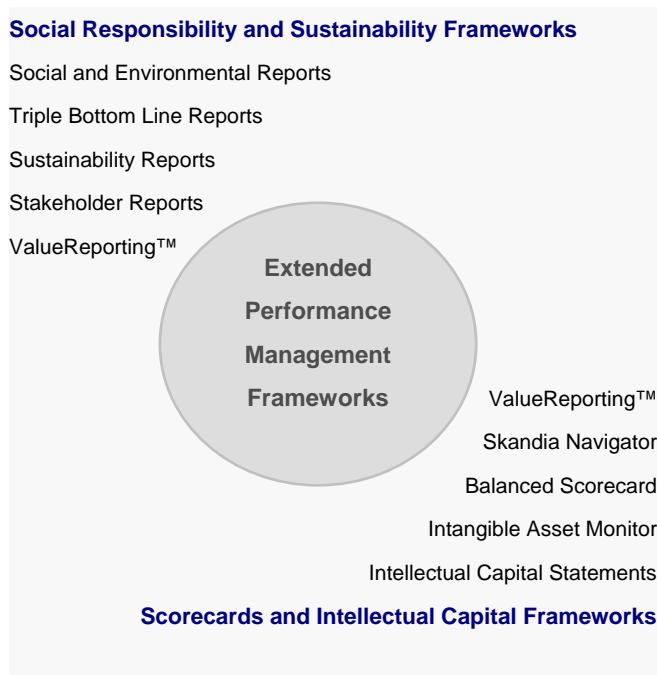
Stakeholders, in particular investors, want information about the drivers of business value, not merely bottom line results. They are looking for future oriented performance information which show how an organisation is positioned to create value across different time horizons. Thus, there is a growing demand for dependable performance information, which goes beyond the traditional financial performance accounts.

The criticism and limitations of traditional financial accounts have led to the emergence of a series of “new” frameworks, intended to broaden the traditional approach to measuring and accounting for organisational performance. We label these frameworks extended performance management frameworks.

EPM frameworks can broadly be grouped into two categories (Figure 2):

1. Corporate social responsibility and sustainability frameworks, which trace stakeholder perspectives and external impacts of organisational activity, be they environmental, social, or economic.
2. Scorecard and intellectual capital frameworks, which focus on internal management activities and impacts and place the management, measurement and reporting of organisational knowledge intensive resources within a strategic context.

Figure 2: Extended Performance Management Frameworks²



² The ValueReporting™ framework addresses both external impacts of organisational activity and internal management activities, hence the double listing of this framework.

Contemporary literature and research on EPM illustrate how such frameworks are useful to organisations.

Among others, they:

- enable managers and others to visualise the value and performance of the organisation’s knowledge intensive resources, not recorded and accounted for in traditional financial accounts;
- provide systematic processes and structures for measuring and reporting the value and performance of knowledge intensive resources;
- facilitate a more balanced perspective on resource performance, and provide a broader scope for strategy formulation and resource allocation;
- shed light on the drivers of business value, and how these value drivers are currently managed, thus extended the traditional \$-based approach to performance evaluation;
- provide opportunities for stakeholder identification, engagement and dialogue, resulting in reciprocal communication flows, strategic feedback and organisational learning;
- reduce information asymmetry between internal and external stakeholders, thus opening up new opportunities for financial valuation;
- increase awareness of organisations’ social, economic and environmental impacts and contributions; and
- provide new opportunities for organisational learning, development and innovation.

To better understand the structure and characteristics of EPM frameworks, we have identified seven leading frameworks and examined their differences and similarities in accordance with seven predetermined criteria. The seven criteria raise the following questions:

1. Does the EPM framework identify the level and type of activities undertaken by management to manage the organisation’s knowledge intensive resources? Examples of such activities may include customer relationship management, human resources management, information management, technology management etc.
2. Does the EPM framework link the knowledge management activities to the organisation’s strategic objectives? An example may include aligning a management activity, such as a new learning and development programme, to a strategic objective, such as service excellency.
3. Does the EPM framework facilitate the reporting of extended performance measures? Examples of such measures may include customer satisfaction, employee turnover and new product development (see section 4.3 for more examples).
4. Does the EPM framework report performance against established targets? An example may include a target indicator for customer retention of 67 percent versus actual achievement of only 64 percent.
5. Does the EPM framework facilitate stakeholder consultation and feedback? Examples may include opinion polls and surveys, which investigate and surface the value perspectives and needs of key stakeholder groups.

6. Does the EPM framework consider the external impacts of organisational activity? Examples may include contributions to national GDP, assessment of environmental impacts, community donations, etc.

7. Is the EPM framework used for internal and external reporting purposes?

Table 3 summarises the outcome of the comparative analysis, illustrating the differences and similarities of the seven EPM frameworks.

Table 3: Comparative Summary of Extended Performance Management Frameworks

	1. Identifies Knowledge Management Activities	2. Links Knowledge Management Activities to Strategy	3. Reports Non-financial Performance Measures	4. Reports Performance Against Target	5. Facilitates Stakeholder Consultation and Feedback	6. Considers External Impacts (Social, Economic and Environmental)	7. Used for Both Internal and External Reporting Purposes
Balanced Scorecard ³	Y	Y	Y	Y	Y	N	N
GRI – Sustainability Reports ⁴	Y	Y	Y	Y	Y	Y	Y
Intangible Asset Monitor ⁵	N	N	Y	Y	Y	N	Y
Intellectual Capital Statements ⁶	Y	Y	Y	N	Y	N	Y
Skandia Navigator ⁷	Y	Y	Y	N	Y	N	Y
Triple Bottom Line Reports ⁸	Y	N	Y	Y	Y	Y	Y
ValueReporting™ ⁹	Y	Y	Y	Y	Y	Y	Y

³ See Kaplan and Norton's Balanced Scorecard, www.balancedscorecard.org

⁴ See the Reporting Guidelines issued by the United Nations. The next version of the guidelines is due in 2006.

⁵ See Sveiby's Intangible Asset Monitor, www.sveiby.com

⁶ See the "Intellectual Capital Statements - The New Guideline", published by the Danish Ministry of Science, Technology and Innovation

⁷ See Skandia's website www.skandia.com

⁸ Inspired by the Ministry for the Environment's 2002 review of Triple Bottom Line Reporting in the New Zealand public sector.

⁹ See PricewaterhouseCooper's website, www.pwc.com

The following general observations can be made in regards to Table 3:

- All frameworks consider the activities associated with the management of knowledge intensive resources (column 1). The frameworks provide insights into the way in which the knowledge intensive resources are managed, thus helping to answer the “how” question that traditional financial reports do not answer.
- All frameworks prioritise stakeholder consultation and engagement (column 5). This reflects the growing emphasis on reciprocal information flows between organisation and the people the organisation seeks to create value for.
- The Balanced Scorecard, the Intellectual Capital Statement model, the Skandia Navigator, and the Intangible Asset Monitor do not explicitly consider the external impacts of organisational performance, such as community impacts, contributions to GDP or environmental impacts (column 6). These frameworks focus to a larger extent on internal management activities and impacts.
- All frameworks, with the exception of the Balanced Scorecard, are used for both internal and external reporting purposes (column 7). The Balanced Scorecard is predominantly used for internal reporting purposes¹⁰.

they differ from the reporting categories of traditional financial accounts.

The above analysis has provided a brief introduction to the content of some of the most commonly used EPM frameworks. In the following sub-section, we extend the analysis of EPM frameworks to provide illustrations of the reporting categories of such frameworks, and how

¹⁰ It should be noted that some public sector organisations have published their Balanced Scorecards to external stakeholders.

4.2. Extended Performance Accounts

The EPM frameworks, discussed in section 4.1, help facilitate the preparation of what we call “extended performance accounts”. In this section, we examine the most common reporting categories of such extended performance accounts, and contrast these with the reporting categories of traditional financial accounts. The objective is to gain an insight into the differences in reporting content of the traditional versus the “new” accounts of organisational performance.

Table 4 summarises in table format the differences in reporting categories between the two types of

performance accounts. It illustrates the vast amount of information not recorded on the balance sheet (non-shaded areas). This is contrasted by the limited amount of intangible resources accounted for in the traditional balance sheet (shaded area in upper left hand corner).

The key point to note in Table 4 is that extended performance accounts recognises and records an organisation’s knowledge intensive resources, be they *relational, structural* or *human*. They help “make visible” these strategically important resources, thus providing new perspectives on organisational performance and creating new opportunities for management intervention and financial valuation.

Table 4: Differences in Reporting Categories¹¹

	Traditional Financial Accounts			Extended Performance Accounts		
	Monetary	Physical	Intangible	Structural	Relational	Human
Tangible Resources	Cash Receivables Payables Securities	Property Plant Equipment Inventory	Intellectual Property Customer Lists Brands Contractual Agreements	Documented Operating Policies Documented Company Programmes (i.e. TQM, JIT, Six Sigma, SPC etc).	Contractual Agreements with Alliance Partners and Joint Ventures	Employment Contracts Training Manuals In-house Learning and Development Programmes
Intangible, Knowledge Intensive Resources	Credit Rating Borrowing Capacity Strength of Balance Sheet	Plant Flexibility Tradability of Assets Quality of Inventory	Infrastructure Working Capital Management	New Product Development Management Processes and Programmes Information Systems and Processes Software Programmes Organisational Structure and Culture Management Philosophy	Government Relations Community Relations Distribution and Supply Channels and Relations Customer Relations Financial Relations Industrial Relations Company Name and Brands	Employee Demographics Employees’ Innovative Capacity Employee Diversity Learning and Development Abilities Educational and Work-related Qualifications Leadership and Top Mng Quality

¹¹ It should be noted that according to the IFRS, the intangible resources featured in the shaded area of the table can only be recorded when purchased externally. The definitions section of the Guiding Principles provides a complete list of intangibles recognisable on the balance sheet according to the IFRS. The table is adapted from Ballou, Burgman, Roos and Molnar (2004, exhibit 4, p. 7).

4.3. Extended Performance Measures

In this section we elaborate on the differences between the traditional and the “new” accounts of organisational performance and take a closer look at the performance measures reported in extended performance accounts. We label these extended performance measures.

Table 5 provides a summary of some of the most commonly used extended performance measures. The summary is inspired by the GRI Reporting Guideline, the Australian Bureau of Statistics’ publication on Measuring a Knowledge Based Economy, the UK Operating and Financial Review, the Danish Guideline on Intellectual Capital Reporting, the German Guideline on Intellectual Capital, and a general review of published extended performance accounts, such as Corporate Social Responsibility reports, Intellectual Capital statements, ValueReporting™ reports and Triple Bottom Line reports.

Table 5 groups the various performance measures into three categories, as follows:

- **Stock:** Column one lists the stocks of the organisation’s knowledge intensive resources. Similar to the balance sheet, it records the level and types of the knowledge intensive resources and shows the position of the resources at a given point in time. Some of these resources may be classified as a liability (i.e. a high level of workplace accidents) or an asset (i.e. an increase in the number of strategic customers).
- **Investments:** Column two lists the investments made into the knowledge intensive resources. The term investment is used in a broader sense to signify not only capital investment, but also other types of resource investments such as time, energy, expert knowledge etc.

- **Effects:** Column three lists the possible effects of the investments made into the knowledge intensive resources. Similar to the profit and loss statement, this column shows the outcomes of performance for a given period of time. The result of a given investment may, for example, be an increase in work place productivity or an increase in community perception of corporate conduct.

One of the main points to note in Table 5 is the focus on organisational effects (column 3). Thus far, demonstrating the value that accrues from investing in knowledge intensive resources has been a challenge to researchers and practitioners alike, possibly serving as a barrier to increasing the uptake of EPM. There are a number of reasons for this.

One reason is the difficulty of excluding intervening variables and determining in isolation the effect of a given action. For example, an increase in customer satisfaction may be due to a number of simultaneous management activities and investments, such as new product development, staff training or an extension of distribution channels. Determining in isolating the cause of the change in performance outcome is thus a key challenge to understanding the value that accrues from investing into knowledge intensive resources.

A second reason is the challenges associated with isolating the time period for determining the effect. For example, a new automobile advertising campaign launched at the beginning of the year may trigger a customer to purchase the product at year end, or the following year. The challenge thus lies in determining the timing of the inflow (capital or other) that accrues from the given investment.

A third reason pertains to the issue of *circularity* and the fact that most performance measures are both input and

output measures. For example, a measure of customer satisfaction is commonly seen as an output of past strategy. It tells the effectiveness of past business performance. It is however also commonly seen to be an input into (the formulation of) future business strategy. For example, in a scenario where customer satisfaction proves to be lower than expected, strategy is likely to be amended to alleviate points of dissatisfaction. Thus, the challenge lies in determining the role and meaning of extended performance measures. What is the cause and what is the effect?

Understanding the issues impacting the use, effects and meaning of extended performance measures remains a challenge to researchers and practitioners alike. It is, however, a prerequisite for justifying investments into knowledge intensive resources, and thus, more testing and empirics are required to establish their value.

We welcome readers of this publication to participate in pilot projects facilitated by the *Society for Knowledge Economics* to increase empirical evidence substantiating the effects and benefits that flow to organisations who measure and report the value and performance of their knowledge intensive resources.

Table 5: Examples of Extended Performance Measures¹²

	1.Stocks of Knowledge Intensive Resources and Activities	2. Investments (Time, Capital, Resources etc) in Knowledge Intensive Resources	3. Effects
Structural	<p>Number and types of innovation projects / teams</p> <p>Number of patents, licences and trademarks</p> <p>Number of six sigma projects completed</p> <p>Number of cross-functional teams</p> <p>Number and type of operating and policy procedures</p>	<p>Expenditure on innovation as a proportion of total expenditure</p> <p>Investment made into process reengineering</p> <p>Expenditure on ICT infrastructure</p> <p>Investment made in culture change programme</p> <p>Investment made into corporate governance programme</p>	<p>Financial:</p> <ul style="list-style-type: none"> - Share price/ EPS - ROE - ROA - Leverage - Working capital ratios <p>Customers:</p> <ul style="list-style-type: none"> - Satisfaction, - Retention/ churn - Acquisition - Segments proliferation - Share of market according to customer segment or geographic location - Change in stock indicators
Relational	<p>Number of strategic customers</p> <p>Three largest customers as percent of turnover or profit</p> <p>Number and/or types of strategic alliances and partnerships</p> <p>Number and/or types of research projects with universities or scientists</p> <p>Number of analyst briefings held</p> <p>Number of employees represented by trade unions</p> <p>Number of products/services sold through online media</p>	<p>Marketing expenditure as a proportion of sales or profit</p> <p>Investment in customer surveying and analysis</p> <p>Investment made into environmental management programmes</p> <p>Donations to community as proportion of profit</p> <p>Investment made into non-core business infrastructure, i.e. schools in local communities</p> <p>Investment into supplier chain management activities</p> <p>Investment into developing or improving distribution channels</p>	<p>Employees:</p> <ul style="list-style-type: none"> - Satisfaction - Morale - Retention and turnover - Change in stock indicators <p>Business Processes:</p> <ul style="list-style-type: none"> - Productivity - Efficiency - Effectiveness levels <p>Environmental:</p> <ul style="list-style-type: none"> - Levels and/or type of omission gasses - Waste levels - Water consumption - Energy use by energy source
Human	<p>Workforce demographics (age, gender)</p> <p>Workforce competency profile, i.e. number of researchers, accountants</p> <p>Number of staff enrolled in training / education courses</p> <p>Number of staff having completed designated training / certification / leadership courses.</p> <p>Number and type of workplace accidents</p>	<p>Investment made in leadership development programme</p> <p>Expenditure on education or training per employee as a proportion of sales or expenses</p> <p>Average number of training / education hours per employee according to employee category</p> <p>Investments made into staff surveying</p> <p>Investments made into OH&S</p> <p>Investments made into diversity and equal opportunity programmes</p>	<p>Social:</p> <ul style="list-style-type: none"> - Public perception of corporate conduct - Impact of operations on community - Bribery and corruption <p>Economic:</p> <ul style="list-style-type: none"> - Contribution to GDP - Tax payments - Cost of goods, services and products purchased according to region or country - Total payroll by region or country

¹² These measures are not exhaustive but intended as sample measures only. It should also be noted that the measures in the three columns are displayed as independent measures, and have, in the current display, no relationship with each other.

The extended performance measures summarised in Table 5, differ to traditional financial performance measures in a number of ways (Table 6).

Table 6: Traditional versus Extended Performance Measures

Traditional Performance Measures	Extended Performance Measures
<ul style="list-style-type: none"> ▪ Lagging indicators (i.e. historical performance) 	<ul style="list-style-type: none"> ▪ Lagging and leading (i.e. future oriented)
<ul style="list-style-type: none"> ▪ Stocks of tangible resources 	<ul style="list-style-type: none"> ▪ Stocks and flows of intangible resources
<ul style="list-style-type: none"> ▪ \$-based outcome measures 	<ul style="list-style-type: none"> ▪ Insights into resource use and development
<ul style="list-style-type: none"> ▪ Unit inputs and output 	<ul style="list-style-type: none"> ▪ Cause-effect relations
<ul style="list-style-type: none"> ▪ Production optimisation 	<ul style="list-style-type: none"> ▪ Strategic significance

Extended performance measures:

- **are forward looking (leading well as lagging indicators)**, and provide insights into how an organisation is positioned to create value in the future. Customer retention is an example of a leading indicator of future financial performance. It is based on the assumption that higher retention rates positively affect future financial performance. However, as previously mentioned, customer retention is also a lagging indicator, telling a story of the past success of the organisation’s business strategy. Thus, it is both a leading and a lagging indicator;
- **provide insights into the flow of resources**, not merely the stocks of tangible resources. Extended performance measures show how an organisation’s knowledge intensive resources are used and developed over time, thus extending the traditional short-termist focus on bottom line results. An

example may include the recoding of the number of innovation projects or investments made into a leadership development programme;

- **track the cause-effect relations of management activities** across functional structures, work groups and value networks, not merely unit inputs and outputs. Tracking the cause-effect relations is commonly done through statistical analysis whereby a change in investment or expenditure is correlated with changes in performance outcomes, be they operational, customer related, financial, community related or other; and
- **emphasise the strategic significance of management activities**, thus extending the traditional short-termist focus on production optimisation. For example, extended performance measures can be used to track investments made into culture change programmes, research activity and community development activities. Such investments have a longer time horizon for benefits realisation when compared to operational measures of unit inputs and outputs. They are of strategic significance and help build organisational sustainability and competency.

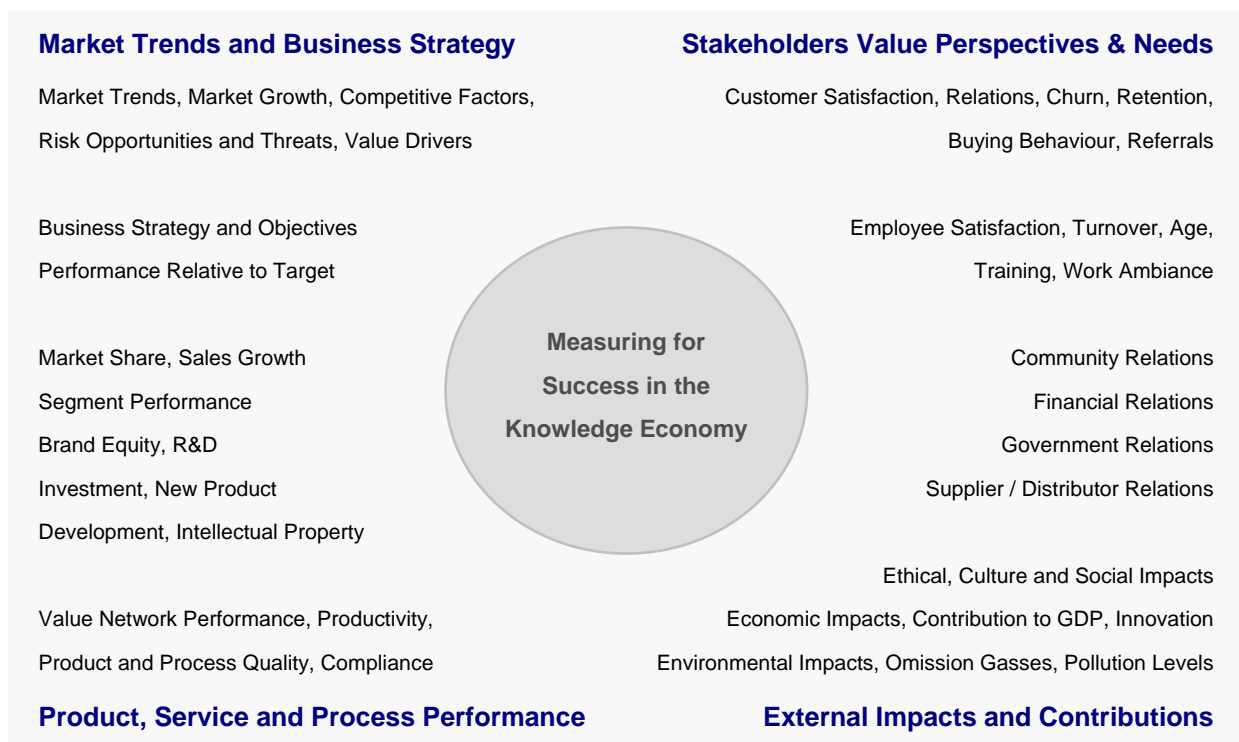
We conclude this section by proposing a mind map for thinking about the different types of extended performance measures available to organisations who engage in the creation of an extended performance account. The purpose is to emphasise that performance measures must be set within a broader, strategic context of market trends, organisational strategy and operations, stakeholder value and environmental impacts and contributions. Figure 3 provides a graphic illustration of the mind map, grouping the measures into four broad categories:

- **Market Trends and Business Strategy:** These measures show how an organisation is positioned in the market place and outline the macro and industry forces that are affecting its performance.
- **Products, Services and Business Processes:** These measures show how an organisation is managing and developing its products, services and internal business processes to maximise value creation.
- **Stakeholder Value Perspectives and Needs:** These measures show how an organisation’s stakeholders perceive of its ability to create value.

- **External Impacts and Contributions:** These measures show how an organisation affects its external environment, including its social, environmental and economic contributions and impacts.

We revert to the concept of extended performance measures and how such measures can be used within a strategic business context in sections 5 and 6, where we detail the proposed framework and management processes for preparing an extended performance account.

Figure 3: Mind Map: Contextualising Extended Performance Measures ¹³



¹³ The overview of measures illustrated in this figure has been inspired by Exhibit 3 in McKinsey’s (2005) survey “The View from the Boardroom”, and a general review of the literature on extended performance measures (see the list of Referenced Documents in section 8).

4.4. Effects and Benefits of EPM

The previous section outlined the many challenges associated with demonstrating the value that accrues from investing in knowledge intensive resources. In this sub-section, we provide a brief review of some of the empirical evidence provided thus far, illustrating the benefits to organisations who embrace the agenda of EPM.

Needless to say, determining the effects and benefits of EPM is critical to justifying investments into knowledge intensive resources. Executives and business managers need evidence illustrating the financial gains and broader workplace benefits that accrue to organisations from investing in EPM.

Table 7 provides a summary of emerging trends in the business and academic literature illustrating the effects and benefits of EPM. The effects are categorised into financial (quantitative) and work place (qualitative).

It should be noted that contemporary studies often emphasise that EPM is a subjective exercise with no so to speak ‘magical’ recipe for success. The value of EPM may not lie in the framework chosen or be realisable in the form of short term financial results. Rather, the value often lies in the processes of implementation and the impact EPM has on employee behaviour, attitude and morale. So whilst we acknowledge the role and importance of the financial effects, we also emphasise the importance of the behavioural and often subjective and qualitative effects that accrue to organisations who engage in EPM.

Table 7: Effects and Benefits of EPM

Financial Effects		Work Place Effects	
Share price	<p>US and European research has shown that an increase in disclosure of extended performance information improves transparency, thus reducing information asymmetry and uncertainty. This leads to a tighter range of share price estimates and a reduction in beta, resulting in more accurate share price valuation and a reduction in the cost of capital.</p> <p>An example includes an experiment conducted by PwC in which one group of analysts was provided with standard financial data whilst another group was provided with both financial data and an intellectual capital statement. The experiment showed that those analysts given both sets of performance data had a lower spread of earnings and assigned a higher share price valuation to the given company.</p>	Cultural	<p>Extended performance accounts have proven to have positive effects on organisational culture and work place practices. Danish studies illustrate that working with intellectual capital statements can help facilitate organisational change and aid the development of a knowledge-based organisational identity (Kjaergaard, 2003). They can help transform employees' work attitudes and lead to heightened levels of trust and motivation, resulting in a greater capacity for innovation, learning and development.</p>
IPO valuation	<p>US studies on Initial Public Offerings (IPOs) likewise find that extended performance information, such as information about product development, R&D and the competitive environment, reduces information asymmetry and assist IPO pricing (Guo, Lev and Shou, 2005).</p>	Reputation	<p>Extended performance accounts have also been proven to increase transparency, provide a vehicle for stakeholder feedback and improve stakeholder communication. Better stakeholder relations positively impact brand values and image, resulting in a larger pool of candidates to recruit from and a greater capacity for customer acquisition and retention.</p>
Profitability	<p>Statistical analyses of organisational performance data have found cause-effect relations between employee attitudes, customer satisfaction and financial performance, thus confirming, as one would expect, that investing in knowledge intensive resources improves financial performance (Ricci et al, 1999).</p>	Managing Knowledge and Risk	<p>Extended performance accounts have also shown to help managers and others better visualise an organisation's knowledge intensive resources, resulting in improved utilisation, management and development of these invisible resources. Knowledge is made manageable and accessible for intervention as performance information is recorded in an extended performance account (Mouritsen and Thorsgaard Larsen, 2005). EPM has also proven to increase employee awareness of organisational activity, strategy and objectives, which in turn helps reduce organisational risk exposure.</p>

5. Proposed Framework and Practical Example

In this section of the *Australian Guiding Principles*, we extend our learnings from the previous sections and propose a simple framework to assist organisations in the development of an extended performance account. We illustrate the use and relevance of the proposed framework by providing practical examples of extended performance accounts prepared by Australian organisations during current pilot projects.

5.1. Framework

Figure 4 outlines the proposed framework for structuring the extended performance account. We propose a one-page account, which provides a summary of the value and performance of the organisation’s knowledge intensive resources and activities relative to its strategic objectives. The account may possibly be thought of as

the “fourth” performance account, complementing the three existing financial accounts: the balance sheet; the profit and loss statement; and the cash flow statement.

The proposed extended performance account framework is valuable in that it is:

- **strategic in nature**, placing knowledge intensive resources within the strategic business context in which they rightfully belong;
- **forward looking**, providing insights into how an organisation is positioned to create value across different time horizons; and
- **simple in structure**, providing a one-page snapshot of the organisation’s knowledge intensive resources and activities.

Figure 4: Proposed Framework for Structuring an Extended Performance Account

	Strategic Objectives	Managerial Efforts		Indicators (External and Internal)		
		Current Activities	Planned Actions	Indicators	Past / Current	Target
Relational Capital						
Structural Capital						
Human Capital						

The proposed framework also meets the seven assessment criteria deployed in section 4. It furthermore extends existing frameworks by providing a simple structure, which, similar to the traditional financial accounts, provides a one-page snapshot of organisational performance. In this case, the focus is on the invisible, knowledge intensive resources not recorded in traditional financial accounts.

Time scarce business managers and other organisational stakeholders often only require a one-page snapshot of organisational performance. The qualitative performance information seen in, for example, corporate social responsibility reports, however valuable, is time consuming to digest and often subjective of nature.

The proposed framework also differs to existing frameworks in that it: 1) combines a broad classification of knowledge intensive resources (y-axis), with a review of the organisation’s efforts in managing its knowledge intensive resources relative to its strategic orientation (x-axis); and 2) extends beyond internal management activities of knowledge intensive resources to encourage an analysis of external impacts of organisational activity, be the social, environmental or economic (see section 6 for more details).

Importantly, extended performance accounts can be used for different organisational purposes, depending on the organisation’s specific needs, requirements and circumstances. Some organisations use the account for **internal management purposes**, as a tool to help managers and others gain new insights into organisational performance. The accounts have also been used as brainstorming and planning tools to improve the effectiveness of resource allocation and strategy formulation; as change management tools to transform workplace culture; and as motivational

devices to improve employee productivity and awareness of organisational identity, activity and intent.

Some organisations also use their extended performance account for **external reporting purposes**. The purpose is to provide stakeholders external to the organisation with a broader perspective on the organisation’s value creating activities and abilities. The account help achieve this objective by showing the value and performance of the organisation’s knowledge intensive resources not accounted for in traditional financial accounts.

In regards to the structure of the extended performance account, the y-axis categorises the knowledge intensive resources into *relational*, *structural* and *human*, as previously illustrated in section 3.

The x-axis of the framework comprises three columns:

- **Column one, labelled Objectives**, lists the Business Objective for each of the resource areas: *relational*; *structural*; and *human*. An example of a strategic objective for say relational capital may be to “develop and sustain profitable customer relations”.
- **Column two, labelled Managerial Efforts**, is divided into Current Activities and Planned Actions. The Current Activities lists the current management activities. An example may be a marketing campaign conducted during the year. The Planned Actions lists the initiatives management plans to take in the future. An example may be the planned implementation of a culture change programme. The Planned Actions are set relative to the Business Objectives, listed in column one.

- **Column three, labelled Indicators**, is divided into three areas: 1) Name of Indicators; 2) Performance of the Indicators (past and current); and 3) Target Performance for the Indicators. The column labelled Indicators lists the name of the performance indicators. This may be customer satisfaction, employee turnover or any other extended performance measure. The column labelled Current / Past Indicators shows the outcome of past performance. The column labelled Target Indicators shows the set target for the performance indicators. The Target Indicators are set relative to the Planned Actions listed in column two and the Business Objectives listed in column one.

The management activities and processes, which inform the creation of the extended performance account, are discussed in more detail in section 6.

We wish to emphasise that the proposed framework outlined in this section of the *Guiding Principles* is provided in draft format. Our medium to long term objective is to test the framework with a larger group of Australian organisations. Processes of trial and error, modifications and learnings await us as we embark on this process. We invite you to embark on this journey with us.

5.2. Practical Examples

A number of Australian public and private sector organisations have embarked on the journey of preparing extended performance accounts. In this section we introduce two of these organisations. We discuss their learnings and provide examples of their draft extended performance accounts.

The two case study organisations are the New South Wales Department of Lands (NSW) (hereafter Lands) and Westpac Banking Corporation (hereafter Westpac).

To both pilot organisations, the overarching objective of preparing the extended performance accounts has been to better understand the value and performance of their intangibles, knowledge intensive resources.

The extended performance accounts prepared by the two pilot organisations however serve different purposes to the organisations. Lands has a dual objective and is using the extended performance account for both internal management and external reporting purposes.

Westpac, in contrast, is intending to use the extended performance account for internal performance management only.

We learn from these “early innovators” that extended performance accounts must be embedded into management thinking and reflect managerial activities and courses of action. An extended performance account is not a disengaged corporate report, driven by regulatory requirements. It is neither a marketing collateral striving to gain public acceptance. It is instead a dynamic account, which helps organisations reflect on their “identity”, their “DNA”, and start a journey in which Purpose (i.e. “where they we going?”) and Means (“how do we intent to get there)” are centered around the strategic management of knowledge intensive organisational resources.

Mini Case Study 1: NSW Department of Lands

The NSW Department of Lands developed its first extended performance account for the accounting year 2004/2005. The project was initiated by Warwick Watkins, the Director General in 2003, and facilitated through relations with members of the Australian Government Consultative Committee on Knowledge Capital.

Lands was created in April, 2003, integrating three separate operating divisions: Land and Property Information (LPI), the provider of land and property information for NSW; Crown Lands, the administrator of all crown lands comprising over half of all land in NSW (which includes around 29mn hectares of land valued at over \$8.3bn); and Soil Services, a specialist conservation earthmoving and soil consultancy business.

Lands had three main reasons for starting the project

1. The first reason is the need to better understand the value and performance of the organisation’s knowledge intensive resources. When interviewed, the Director General commented:

“The greatest value of organisations in today’s business environment is in intangible assets. However, in most organisations, senior executives pay little attention to the greatest asset in their organisations; that is the knowledge or intellectual capital. Decision-making is skewed towards short-term materialistic gains, which undervalues the real value and influences whether an organisation is sustainable or not. At the moment, organisations are undervaluing their true wealth. We need to develop a greater sense and appreciation and awareness of the true value of what the intangibles are, and in doing so, be able to better allocate financial and other related resources. We need to be able to, in a structured sense, have an objective discussion about where we should be cutting or increasing our resource allocation. Our objective is to get a better understanding of what constitutes the organisation, the value of the organisation, and how we can use that knowledge generally, augmented with other tools, to bring about better decision making.”

2. The second reason is Lands’ ageing workforce, with up to 44 percent of staff scheduled for retirement over the next three to five years. Critical questions have been raised as to how to capture and transfer the knowledge held by the retiring staff to sustain the existence of Lands. A representative from Finance explained:

“Knowledge loss is expensive. If we relinquish expert knowledge, we are letting go of a host of things that we need to retain for the health of the business. If a key person with the background, experience and knowledge leaves without having passed on the knowledge, you might need two people in order to undertake that same task, so there are cost and financial implications involved.”

3. The third reason pertains to the use of performance information by external stakeholders. Executives raised questions as to how governments and others can adequately judge, value, assess and make forecasts about organisational performance without having access to critical information about the knowledge intensive resources and activities that underpin the organisation’s value creation activities and abilities. The executives at Lands seek to address the limitations of traditional financial reports by creating an extended performance account illustrating the value, utilisation and performance of the organisation’s knowledge intensive resources.

Project Aims

- Measuring:** Clarify the need to identify, agree and assign metrics to assess the efficient use of organisational knowledge intensive resources.
- Reporting:** Develop a framework to communicate, in a balanced way the value created through the knowledge intensive resources.
- Managing:** Identify and prioritise management challenges in creating sustainable value.

Approach and Methodology

- Involved establishing existing management, measurement and reporting practises within the Department, and recommending a possible extended performance account and action plan for the agency.
- Involved the creation of an Organisational Capabilities Project Team responsible for consulting and driving forward the project across the operating divisions and support functions.
- Involved visionary leadership and engagement of managers and staff through participation and consultation.
- Involved primary research through semi-structured interviews and secondary research by means of content analysis and review of internal documents.

Actions

1. Agreement on what knowledge intensive resources are and why they are important.
2. Agreement on an extended performance management framework.
3. Development of divisional projects and project teams.
4. Implementation of data gathering systems.
5. Agreement on the content of the extended performance account.

Outcomes & Deliverables

1. Identified key management challenges and initiatives from a knowledge perspective.
2. Identified the gap between "perceived importance" and "actual management" of the organisation's knowledge intensive resources.
3. Created an extended performance account.
4. Raised awareness of issues surrounding the management of knowledge within the Department.

Lessons Learned

1. The project raised awareness of knowledge intensive resources within the three divisions and the importance of viewing the money spent on the development of knowledge intensive resources as an investment in the future and not a current cost.
2. The project facilitated the initiation of "strategic conversations" which involved discussions about *organisational identity, strategic priorities and management challenges*. It helped management reflect on the way in which the organisation addresses its strategic issues and how these issues are viewed through the lens of knowledge. The Chief Information and Technology Officer pointed out:

"The project is giving us the ability to see ourselves and what we are made of, our DNA. It helps us initiate a process of self-reflection, and to better clarify and describe who we are and what we are doing. It helps us to start to see ourselves differently. It is also a way of envisioning the future and assessing where we can go, how we can change and how we can better organise ourselves to move forward. It is helping us create a healthier organisation".

3. The project was at times hampered by difficulties with breaking down organisational barriers that prevented the communication of important information and impeded progress. Clear objectives, strong leadership and the communication of practicable outcomes, both in regards to engaging staff and measuring results, are pre-requisites for project success.
4. "The process is iterative; as we learn more about knowledge and how it creates value, our assumptions concerning appropriate measurement and reporting are challenged." (Senior Policy Officer at Lands)

Recommendations

- Further research on appropriate measures particularly in relation to knowledge and relationships is required.
- Keep the language simple and further develop consensus on clear definitions. Ambiguous terminologies and unclear definitions can negatively impact the engagement of management and staff, causing confusion and (unproductive) debate.
- Develop a community of interest to facilitate sharing of experiences and learning in relation to the management, measurement and reporting of knowledge intensive resources.
- Extend the process to other government agencies.

Figure 5: Draft Extended Performance Account (NSW Department of Lands)

	Objectives (Business Orientation)	Managerial Efforts		Indicators (External or Internal)					
		Current Activities	Planned Actions	Indicator	02/03	03/04	04/05	Trend	Target ¹⁴
Relational Capital	Better Management of External Stakeholder Relationships	Collaborative Research with Universities	Stakeholder Consultations	Number of Significant Committees with Statutory Bodies	40	32	36	↗	
		Liaison and Collaboration with Professional Associations Interagency Committees	Customer Survey		Research Partnerships	2	2	6	↗
Structural Capital	Improve Service Delivery	Development of Marketing Tools	Assessment of Distribution Methods (face-to-face versus web based)	Average Number of (monthly) Internet Feedback Requests	-	-	285		
		Analysis of Client Profiles Quality Management Methodology IT	Ongoing Transition to Web Based Technologies	Average Number of Hits on Website (monthly)	-	-	1.8mn		
Human Capital	Better Management of Employee Demographics	Learning and Development	Identification of Tacit Knowledge in the Workforce	Number of Full Time Staff	1458	1441	1427	↘	
		Training	Mentoring Programme	Average Age of Employee	-	-	45		
		Apprenticeships	Employee Satisfaction Survey	Number of Staff Attending External Courses	-	246	-		
		External Studies		Number of Staff Attending Internal Courses	-	462	-		
		Internal Seminars		Number of Staff as Being NEBS	15.3	15.7	15.3	↗	
		IT		Women as a Percent of Total Staff	34.8	35	36.4	↗	

¹⁴ This organisation has chosen not to specify target indicators.

Mini Case Study II: Westpac Banking Corporation

Westpac Banking Corporation is currently in the early stages of developing its first extended performance account. The project was initiated by Bruce Hills, Head of Risk, and facilitated through the Australian Government Consultative Committee on Knowledge Capital.

The pilot project is conducted by the Business Technology Solutions and Services (BTSS) group. BTSS is a shared services unit that delivers back-office functions for all of Westpac's products. The group defines the overall information technology architecture; supports and enhances software systems; and manages and implements major projects. BTSS also provides infrastructure support for cash management, fraud, physical security, business services and records management. Overall, BTSS can be considered the backbone of the organisation and the enabler of the interfaces that satisfy the day-to-day banking requirements of Westpac's diverse customer base.

Westpac's motivation for embarking on the EPM project

The main reason for embarking on the extended performance management project is to demonstrate the intangible value delivered by BTSS to: 1) its partner business units; and 2) the end user of Westpac's products and services.

The value that BTSS creates for its partner business units and end customers is invisible. Indeed, the internal accounting system charges Westpac business units for their use of BTSS resources. The result is that BTSS is considered a cost rather than a source of value. Overall, BTSS faces the challenge of articulating how spending on its knowledge intensive resources are investments in long-term capability and value to the end customer, rather than costs and detriments to the 'bottom line'.

The anticipated benefits of the EPM project relate to:

- improved resource allocation due to availability of better information for business decision making;
- improved service delivery to partner business units and end customers, resulting in heightened levels of customer satisfaction;
- enhanced business performance across the partner business units due to BTSS' better understanding of their service requirements and needs;
- heightened levels of employee engagement and commitment due to enhanced understanding of business objectives, service delivery and strategy;
- improved understanding and management of knowledge flows between BTSS and the partner business units; and
- heightened levels of work place and employee innovation.

Project Aims

- Measuring:** Examine existing measurement and reporting systems and processes and the extent to which they: (a) capture attributes of strategically important knowledge intensive resources; (b) communicate and measures the value that BTSS provides to its partner business units and end customer.
- Reporting:** Investigate the impact of extended performance accounts on managerial decision making and performance evaluation.
- Managing:** Assess the knowledge flows and transfers from BTSS to its partner business units and end customer.

Approach and Methodology

The project at BTSS tests the proposed management steps for developing extended performance accounts recommended by the *Guiding Principles on Extended Performance Management*. This involves six process steps, grouped with three management phases, as follows:

- **Business Orientation**, in which the strategic orientation of BTSS is established, highlighting issues of use value and service delivery.
- **Business Analysis**, in which BTSS' business environment, stakeholder needs, resource composition and resource management activities are analysed.
- **Performance Evaluation**, in which the current performance of BTSS relative to its stakeholder needs is understood and assessed.

Section 6 of the *Guiding Principles* provides more details about the management steps.

The following methods are applied to facilitate the project at BTSS:

- Analyses of internal and external business documentation to determine the strategic orientation and intent of BTSS, relative to the organisation's broader strategy, and relative to the measurement and reporting systems and processes currently applied to evaluate the performance of BTSS.
- Interviews with key stakeholders to understand the services provided by BTSS; the extent to which value delivery is successful; and the ways in which the performance of BTSS is currently understood and

assessed by key stakeholder groups.

Planned Actions

1. Scoping and project planning, including agreement on the purpose, content and intended use of the extended performance account.
2. Awareness raising exercises in the form of presentations and brainstorming sessions.
3. Identification of key stakeholder groups and development of project team(s).
4. Recommendations on the preparation of an extended performance account.
5. Interviews and workshops.
6. Data analysis.

Outcomes & Deliverables

The overarching objective of the pilot project is to develop a draft extended performance account for BTSS to use in demonstrating the value it provides to its partner business units and the end user of Westpac's products and services.

Lessons Learned and Recommendations

The project is at the early stages and thus lessons learned and recommendations are not yet available.

Figure 6: Indicative Extended Performance Account (BTSS at Westpac Banking Corporation)

	Objectives (Business Orientation)	Managerial Efforts		Indicators (External or Internal)					
		Current Activities	Planned Actions	Indicator	02/03	03/04	04/05	Trend	Target
Relational Capital	Evaluate Intangible Value Delivered by BTSS to Partner Business Units and End Customers	Research Project with Macquarie Graduate School of Management	Development of Extended Performance Account Identifying Intangible Value of BTSS Service Stakeholder Consultation and Surveying Articulation of Value Delivered to Stakeholders by BTSS Services	Customer Satisfaction with BTSS Services					
				Partner Business Unit Satisfaction with BTSS Services					
Structural Capital	Improve Process Efficiency and Service Delivery	User Friendly Service Delivery 24/7 Through IT and Automation	Test and Verify Assumption that Customers Perceive 24/7 as a Value Add	Percent of Customers Using Online Services					
				Customer Satisfaction with Online Service					
Human Capital	Identify and Understand Knowledge Flows and Transfers Between Staff and Customers and between Staff and Staff ¹⁵	Awareness Raising and Assessment of Options are Currently Being Initiated by BTSS.	Identify Points of Interaction between Staff-Customer and Staff-Staff Identify and Analyse Types of Knowledge Communicated and Transferred during Points of Interaction (i.e. Explicit versus Implicit) Track Knowledge Flows/ Impacts	Number of Process Workers					
				Number of Knowledge Workers					
				In progress					
				In progress					

¹⁵ This objective is driven by the transformation in the type of work performed at BTSS, with an increase in the number of “Knowledge Workers” and a decrease in the number of “Process Workers”.

6. Operationalising Extended Performance Management

In this section of the *Australian Guiding Principles*, we provide guidance to help organisations operationalise EPM. We introduce six process steps, categorised within three management phases, intended to help organisations prepare an extended performance account. Our intent is to broaden the traditional approach to measuring and accounting for organisational performance and facilitate a strategic approach to the management of knowledge intensive resources.

We wish to emphasise that the primary objective of these *Guiding Principles* is to encourage better management and development of knowledge and innovation within organisations and across the Australian economy. Any perceived emphasis in this document on reporting, whether for internal or external use, is not done so for the sake of reporting itself. We believe the role of reporting is to support management efforts to produce better organisational performance.

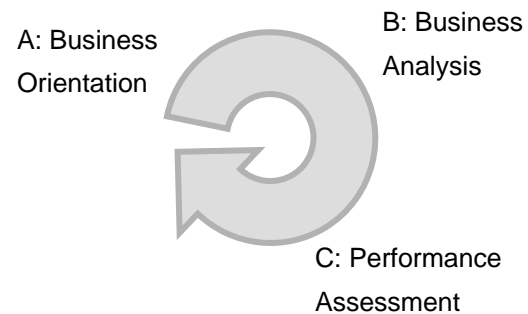
We also wish to emphasise that the management phases and process steps outlined in this section are in draft format. Our medium to long term objective is to test the principles with a larger group of Australian organisations. This will help establish the empirical validity required to influence the creation of guiding principles for national Australia. We acknowledge that processes of trial and error, modifications and learnings await us as we embark on this process. We invite you to join us on this journey.

6.1. Management Phases

Extended performance management must be set within a strategic context, comprising Business Orientation,

Business Analysis, and Performance Assessment (Figure 7):

Figure 7: Management Phases



6.2. Process Steps

The three management phases, Business Orientation; Business Analysis; and Performance Assessment, comprise six process steps. These are discussed within the respective management phase in the following.

A: Business Orientation

Business orientation is the first management phase and comprises one process step (Figure 7, and Figure 9). In this phase, managers are faced with a number of key questions:

- **Organisational Identity:** What is our identity as a group of people, and how do we communicate this identity to organisational stakeholders?
- **Vision for Creating Use Value:** Where do we intend to go, and how do we envision to get there? What “use value” do we envision to create for our stakeholders and how do we intend to create and deliver this value?
- **Knowledge Gaps:** What knowledge do we need in order to succeed in delivering and

creating use value to our stakeholders? E.g. what do we know we know? what don't we know? and what do we need to know to succeed in creating and delivering use value?

The outcome of the business orientation phase is an identification of the organisation's strategic business objectives, relative to its identity, vision for creating use value and knowledge gaps.

B: Business Analysis

Business analysis is the second management phase and comprises four process steps (Figure 7 and Figure 9), as follows:

Market analysis

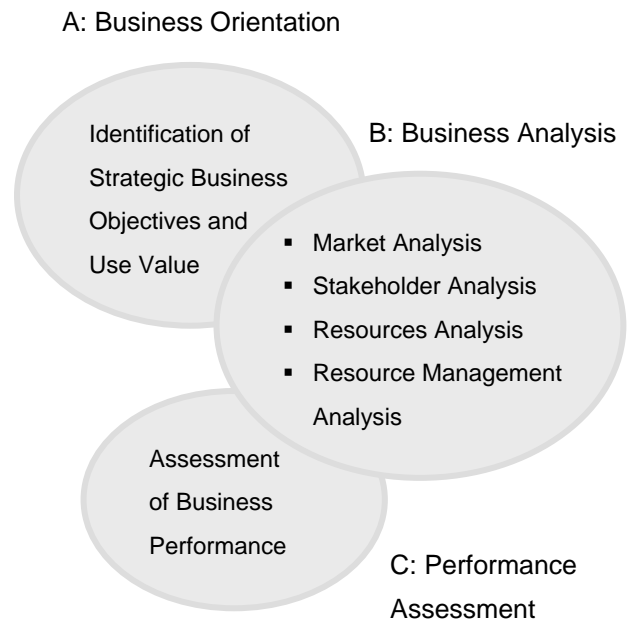
Market analysis includes an analysis of the macro-environmental and industry specific factors that affect the organisation. The objective of market analysis is to identify changes in the external environmental and illuminate how external factors, trends and developments may impact on the organisation and its ability to create value for the stakeholders it serves and affects. Market analysis can help close knowledge gaps and ensure that the organisation is aware of risks and opportunities arising from changes in the external environment.

The following factors and actors are considered in the market analysis:

- Competitors
- Political Factors
- Economic Factors
- Societal Factors
- Technological Factors
- Environmental Factors
- Legal Factors

The outcome of market analysis is a summary of the threats and opportunities the organisation faces as a result of changes in the external environment.

Figure 7: Process Steps



Stakeholder Analysis

Stakeholder analysis pertains to the identification and analysis of the expectations, perspectives and needs of internal and external organisational stakeholders. Stakeholder analysis facilitates reciprocal, as opposed to one way, communication flows between organisations and the people they serve and affect. It provides organisations with new knowledge about the needs and perspectives of key stakeholder groups, thus creating opportunities for reflecting on existing management activities and devising new avenues for organisational development.

Stakeholders include those people external or internal to the organisation, who affect, or are affected by, the organisation's operating activities. External stakeholders

include, but are not limited to:

- Capital Market Actors
- Community
- Customers
- Distributors
- Suppliers
- Government
- Education Providers
- Non-government Organisations

Internal stakeholders include, but are not limited to:

- Board Members
- Consultants
- Contractors
- Employees such as Senior Executives, Managers and Staff

Stakeholder analysis may be facilitated through interviews, surveys, focus groups or other means of stakeholder contact and feedback.

Examples of possible questions to be raised during the stakeholder analysis phase include:

- Customers: What do customers think about the organisation, its products and services, community practices and ethical conduct?
- Employees: What do employees think about the organisation? Is the work environment motivating and stimulating? Are they given opportunities for feedback, career advancement? Do they participate in decision-making? Are they given opportunities for ownership and personal growth?

- Environment: What do environmental groups think about the behaviour and conduct of the organisation? What are the organisation's environmental impacts and contributions?

The stakeholder feedback may be represented in the form of a scorecard quantifying and/or qualifying the value perspectives and needs of stakeholders according to stakeholder category.

The main outcome of stakeholder analysis is the creation of new insights into the value perspectives and needs of the people, or groups of people, the organisation serves and affects. It induces management with new knowledge on which to base decision making and strategy formulation.

Resource Analysis

Resource analysis pertains to the identification and analysis of the organisation's resources (Figure 7 and Figure 9). Organisational resources may be categorised into:

- Knowledge intensive resources:
 - Relational resources
 - Structural resources
 - Human resources
- Monetary resources
- Physical resources

For the purpose of these *Guiding Principles*, the objective of resource analysis is to provide an inventory of the knowledge intensive resources the organisation has at its disposal in its pursuit of value creation. If appropriate, the analysis may be extended to include the physical and monetary resources reported in the balance sheet.

Resource analysis includes recording the composition of the organisation’s knowledge intensive resources.

Examples include, but are not limited to:

- Structural: Number and type of software licences; number and type of new product developments; number of cross functional teams.
- Relational: Number and type of strategic alliances and partnerships; number and type of customers (i.e. strategic versus casual).
- Human: Number of employees; age profile of employees; employees skills and vocations.

The outcome of resource analysis is an inventory of the composition (or stock) of the organisation’s knowledge intensive resources. It complements the balance sheet by recording the intangible resources not recognised by existing accounting standards.

Resource Management Analysis

Resource management analysis comprises an analysis of the activities undertaken by management to manage the organisation’s knowledge intensive resources relative to its strategic objectives.

Resource management activities are classified into five broad categories:

1. Acquisition of knowledge intensive resources
2. Development of knowledge intensive resources
3. Utilisation of knowledge intensive resources
4. Maintenance of knowledge intensive
5. Disposal of knowledge intensive resources

Examples of such managerial activities include, but are not limited to:

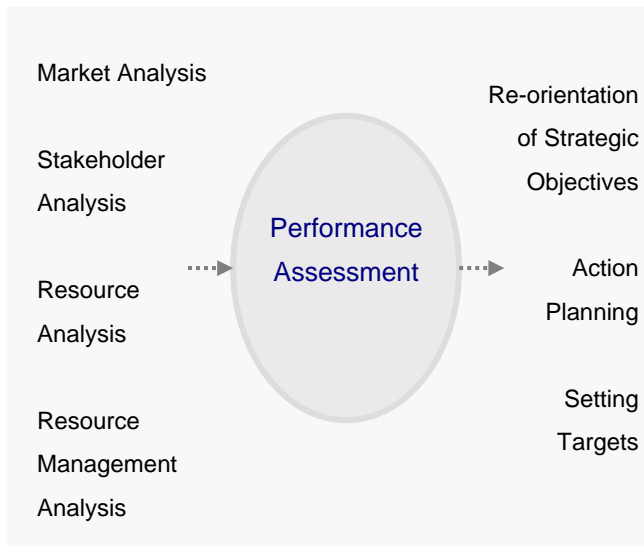
- Structural: Process reengineering; organisational restructuring; leadership development programme.
- Relational: Creation of advertising campaign; community development activities; formation of strategic alliance.
- Human: Sourcing of employees; implementation of learning and development programme; workplace innovation project; retrenchment of staff.

The outcome of the managerial activity analysis is an identification and analysis of the efforts taken by the organisation to manage its knowledge intensive resources relative to its strategic objectives.

C: Performance Assessment

Performance Assessment is the last of the six process steps. It comprises an assessment of the progress made by the organisation at managing its knowledge intensive resources relative to its strategic objectives. Performance assessment is informed by the market analysis, stakeholder analysis, resource analysis, and resource management analysis (Figure 8).

Figure 8: Performance Assessment

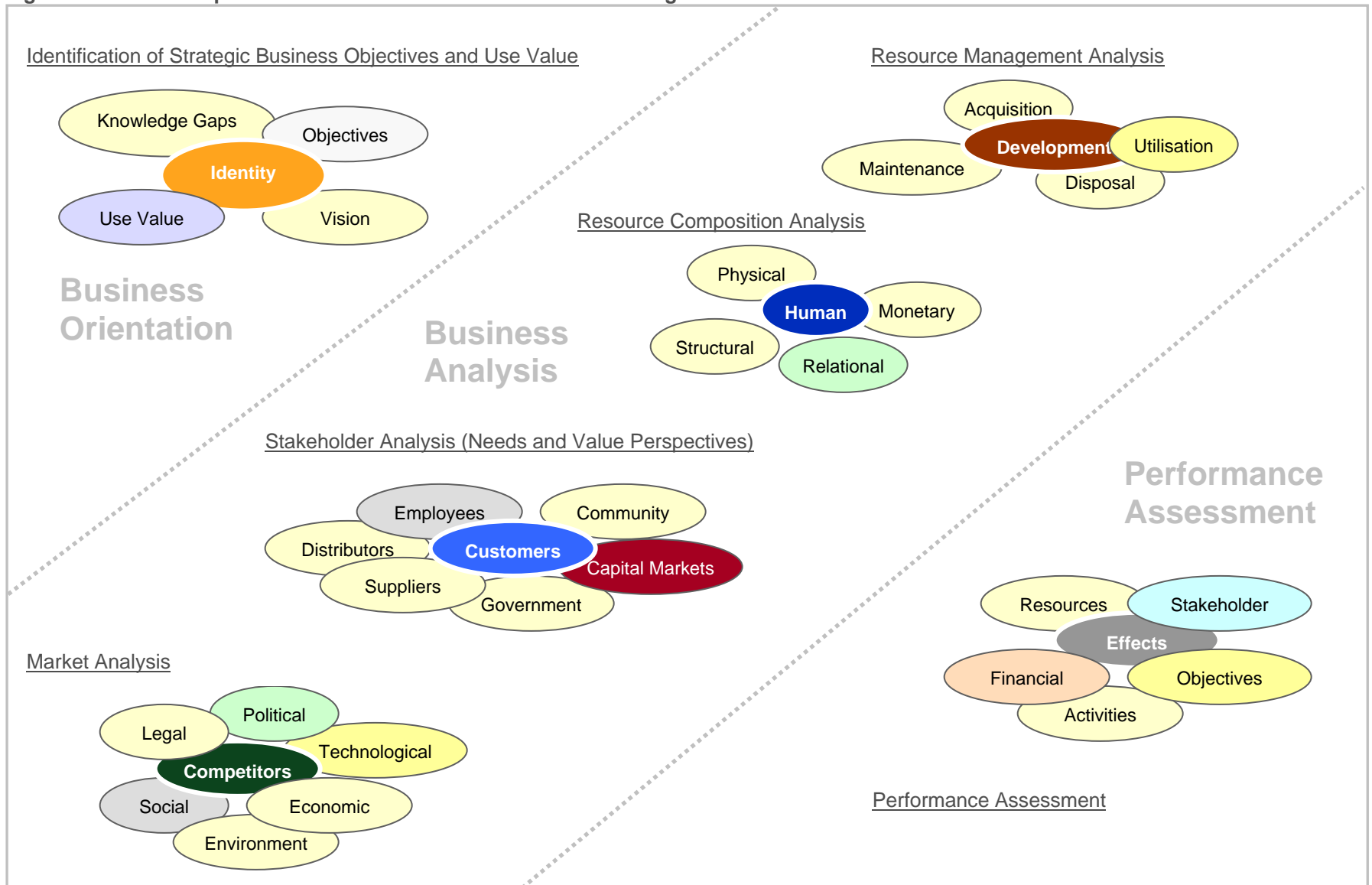


Performance assessment is a continuous process of matching organisational performance against stated targets. It enables managers to reflect on past performance and facilitates the identification of future management action. Information about past performance provides input into action planning and the setting of new strategic business objectives.

Such new strategic business objectives may be informed by extended performance measures, in line with those illustrated in Table 5 in section 4.3. One activity possibly undertaken is an analysis of the effects of a given investment activity. This may incorporate statistical analysis to establish the cause effect relations between investments, stakeholder perspectives and behaviour and / or financial outcomes.

Figure 9 provides a detailed graphical illustration summarising the three management phases and the six process steps.

Figure 8: Process Steps Undertaken in Extended Performance Management



We also wish to point out that organisations that embark on the journey of producing an extended performance account are likely to face a number of important decisions and possible challenges. These may include, but are not necessarily limited, to:

- attracting resources;
- developing and sustaining interest and commitment from executives, employees and others;
- attracting (visionary) teams leaders;
- determining levels of responsibility and accountability;
- project planning;
- overcoming employee resistance and challenging the status quo; and
- identifying and tracking the value and performance of knowledge intensive resources.

The *Society for Knowledge Economics* aims to establish knowledge forums for organisations to come together and share their challenges, learnings and experiences on the preparation of extended performance accounts.

7. How Does the Future Look?

In this last section of the *Australian Guiding Principles*, we review recent trends and developments in national and international legislation, guidelines and codes of conduct. We also comment on the challenges facing practitioners and public policy makers in advancing the uptake of EPM, and point towards a series of action points to help pave the way forward.

7.1. International Trends and Developments – Legislation and Guidelines

In this first section, we provide a brief overview of the trends in legislation, codes of conduct or national guidelines on EPM.

The key findings of our analysis are summarised in Table 8, which shows an increase in international standards and guiding principles on how to manage, measure and report knowledge intensive organisational resources.

Key trends include:

- **The UK Operating and Financial Review**, which now mandates UK public listed organisations to report on environmental, competitive and regulatory factors, risks and uncertainties, business objectives, and strategies for achieving the business objectives. To the extent necessary, the OFR also requires organisations to report on stakeholder relations, social and community issues, environmental matters, employees, customers, and key performance indicators. The OFR came into effect on April 1, 2005 (see Appendix A for more details on the OFR).
- **The 15th Corporate White Paper on Corporate Social Responsibility**, issued by the Japanese Association of Corporate Executives, the Keizai Doyukai, proposes a draft CSR standard called *Practical Tools for Evaluating the Current Situation and Setting Goals to Enhance Comprehensive Corporate Value*. The aim is to assist organisations in performance evaluation, goal setting, discovery of best practices and risk management. It outlines 110 CSR indicators, which are grouped into five categories: Market, People, Environment, Society and Corporate Governance (see Appendix B for details).
- **The Intellectual Capital Reporting Guideline**, issued by the Danish Ministry of Science, Technology and Innovation in 2003, consists of two parts. The first part informs organisations on how to prepare intellectual capital statements. The second part informs users on how to read and analyse the statements. An intellectual capital statement reports on an organisation's management challenges, knowledge resources, knowledge management activities and performance measures. The reporting categories are set within a strategic context and consider customer use value and the organisation's knowledge narrative. The reporting model has been piloted by over 150 Danish organisations over a five-year period (see Appendix C for more detail about the structure and content of intellectual capital statements).
- **The Austrian Universities Organisations and Studies Act**, which came into effect on 1 January 2004, requires Austrian Universities to produce intellectual capital reports. The reports must be structured into *relational*, *structural* and *human capital* and include an obligatory set of performance

measures for each category (see Appendix D for more details).

- **The Australian Stock Exchange Principles on Good Corporate Governance.** The ASX reporting principles provide a guide to listed entities on best practices in corporate governance and disclosure, emphasising the need for corporate accountability and transparency. It outlines ten Corporate Governance Principles, which among others comment on: Board Structure; Enhanced Performance; Recognising and Managing Risk; Recognising the Interests of Stakeholders; Ethical and Responsible Decision Making; and Timely and Balanced Disclosures (see Appendix E for more details).

Notably, Table 8 shows an increase in guidelines on the management and reporting of knowledge intensive organisational resources in the international sphere. Australia, despite initiatives to increase triple bottom line reporting and the recent ASX principles on corporate governance, appears to lag behind its international counterparts. Existing practices in Australia show a strong focus on environmental reporting, yet there is limited evidence of practices which consider the management and measurement of knowledge intensive organisational resources.

Several factors may help explain the lagging position of Australia in the uptake of EPM. One possible explanation is the lack of a peak body leading the way forward. A second possible explanation is the continued perception of Australia as a mineral and raw material producing, manufacturing economy, resulting in a lack of acknowledgement of the role and importance of knowledge, innovation and technology in sustaining and improving national and organisational productivity and performance. A third explanation may be the lack of

prioritisation of strategic initiatives in the area of knowledge and innovation by professional associations, government officials and education providers.

The lagging position of Australia within the international community poses questions as to which initiatives are required to better position and promote Australia as a leading knowledge economy. It also raises questions as to who will lead the way for the implementation and uptake of such initiatives.

The vision of the *Society for Knowledge Economics* is to take on this responsibility and to lead the way in establishing best practice examples on the management and development of knowledge and innovation in the Australian economy. We believe there is ample space for Australia to take a leadership position in this important and growing field of practice and study.

Our objective is first and foremost to increase awareness of the role of knowledge and innovation in national and organisational productivity and performance. We also aspire to help provide Australian organisations with the ideas, tools and philosophies to better manage, measure and report on their knowledge intensive resources. Such initiatives, we believe, will help advance the productivity and prosperity of Australian organisations, the individuals that work for Australian organisations, the communities they affect and the national economy they seek to advance.

Table 8: Trends in Legislation and Guidelines¹⁶

Legislation		Guidelines, Codes of Conduct and Standards	
Australian Corporations Act/CLERP 9	Requires public listed companies to report on their operations and financial position, business strategies and prospects and performance in relation to environmental regulations	AA1000 AccountAbility Guideline	The Guideline provides guidance on how to establish a systematic stakeholder engagement process. This is used to identify indicators, targets and reporting systems to enhance overall performance.
Australian Financial Services Reform Act	Requires fund managers and financial product providers to disclose the extent to which labour standards or environmental, social and ethical considerations are taken into account in the selection, retention or realisation of the investment.	Australian Greenhouse Challenge Programme	Members commit to preparing emissions inventories and forecasts, identify and undertake abatement plans and reporting progress against the action plan.
Austrian Universities Organisations and Studies Act	Mandates Austrian Universities to produce intellectual capital reports. The reports must be structured into human, structural and relationship capital. For each category, an obligatory set of ratios are required to be reported.	Australian Guideline for Triple Bottom Line Reporting	Consistent with the GRI principles, the guideline provides guiding principles for reporting environmental performance.
Belgium Bilan Social	Requires organisations to report data on the evolution of employment (i.e. training)	Australian Minerals Industry	The industry has issued a framework for Sustainable Development "Enduring Value". Members commit to publish sustainability reports on an annual basis. Metrics are informed by the GRI. Independent verification of reports is required.
Canadian Securities Commission	Requires public companies to report the operating and financial effects of environmental protection requirements, be they future or current.	Australian Securities Institute's Disclosure Guidelines	Guideline for product issuers to disclosure about labour standards or environmental, ethical, and social considerations in Product Disclosure Statements.
Canadian Bank Act	Requires financial institutions with equity of USD 1mn or more to report their contributions to the national economy.	ASX Principles on Good Corporate Governance	Provides a comprehensive guide to listed entities on best practices in corporate governance and disclosure. Emphasises the need for corporate accountability and transparency. The guideline includes ten Corporate Governance Principles.
Danish Financial Statement Act	Requires intellectual capital resources and environmental aspects to be reported if it is material to providing a fair view of the organisation's financial position.	Danish Guideline on Intellectual Capital Reporting	Provide a structured framework for organisations to manage, measure and report their knowledge resources and knowledge management activities within a strategic context.
Finnish Accounting Act	Requires certain public companies to report material non-financial issues in their annual report.	Danish Social And Ethical Accounts	Provides guidance on how to report social and ethical initiatives and activities.

¹⁶ This table has been adapted from KPMG's International Survey of Corporate Responsibility Reporting 2005.

EU Integrated Pollution Prevention and Control Directive	Member states are required to register emission data from large companies.	Dow Jones Sustainability Index	The Dow Jones Sustainability Index was the first index to try to assess the ability of businesses to create long-term shareholder value. It focuses on identifying future value potential and uses a defined set of criteria to assess the opportunities and risks deriving from economic, environmental and social developments. A major source of information is the SAM questionnaire, which is completed by companies participating in the annual review.
French Law no2001-420	Requires public listed companies to report their environmental and social impacts	EMAS	The EUR Eco-Management and Audit Scheme enables organisations to evaluate, report and improve their environmental performance.
Germany Bilanzrechts-reformgesetz	Requires German organisations to report non financial performance indicators such as environmental and employee issues.	German Guideline on Intellectual Capital Statements	Issued by the Federal Ministry of Economics and Labour in 2004, the guideline provides guidance on how to prepare an intellectual capital statement. It traces the experiences of a sample of organisations who participated in the pilot projects.
Japanese Law	The Law of Promotion of Environmentally Conscious Business Activities requires certain entities to publish an annual environmental report.	Global Reporting Initiative	Describes itself as a global multi-stakeholder process and independent institution that disseminates and develops globally applicable sustainability reporting guidelines. Encourages organisations to report on the environmental, social and economic dimensions of their services products and activities.
Japan's Pollutant Release and Transfer Register Law	Requires organisations to report releases to the environment of certain chemical substances.	Italy's CSR-SC project	Encourages organisations to produce social statements according to predefined guidelines and criteria.
Norwegian Accounting Act	Requires inclusion of social, environmental and health and safety issues and the implementation of measures to prevent or reduce negative impacts and trends.	International Standards Organisation	Has developed a wide range of standards, including corporate responsibility in the areas of quality and the environment (ISO 9000 and 1400 series).
Spain's Resolucion de 25 de marzo de 2002	Requires reporting of environmental assets, provisions, investments and expenses in financial statements.	MERITUM Guideline	Initiated by the European Commission in 1998; MERITUM stands for Measuring Intangibles to Understand and Improve Innovation Management. Six European countries (Finland, France, Denmark, Norway, Spain and Sweden) participated in the project. The objective was to produce guidelines to measure and disclose intangibles to improve decision-making for managers and stakeholders.
Sweden's Annual Accounts Act	Requires certain companies to include a brief disclosure of environmental and social information in the annual report.	Japanese Guidelines for Environmental Reporting	The Ministry of the Environment has issued two guidelines. One on Environmental Reporting and one on Environmental Performance Indicators.
The Netherlands'	Requires the largest polluters to report on their environmental impacts.	Japanese Keizai Doyukai	The Japanese association of corporate executives has issued its 15 th Corporate White Paper on Corporate Social Responsibility. It

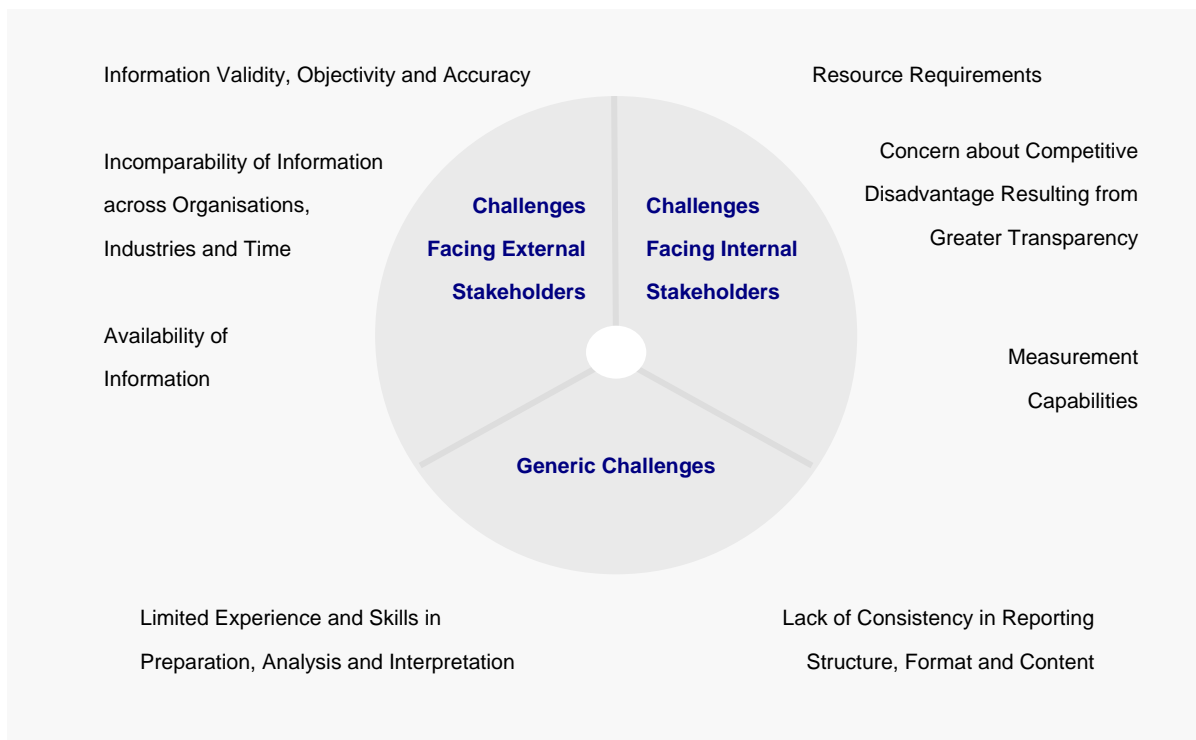
Environmental Protection Act			proposes a draft CSR standard called "Practical Tools for Evaluating the Current Situation and Setting Goals to Enhance Comprehensive Corporate Value".
UK Operating and Financial Review	The OFR requires public listed UK organisations to report on environmental, competitive and regulatory factors, risks and uncertainties, business objectives, and strategies for achieving the objective. To the extent necessary, organisations must also report on stakeholder relations, social and community issues, environmental matters, employees, customers, and key performance indicators.	Japanese Guideline on Intellectual Property	This guideline has been issued by the Ministry of Economy, Trade and Industry. It focuses on strategic IP related issues and provides guiding principles for disclosing information about IP, technology, business strategy and R&D.
US Sarbanes Oxley	Imposed new reporting requirements for public listed companies to increase corporate transparency and governance.	OECD Multinational Enterprise	Provides voluntary principles for responsible business conduct in areas such as human rights, disclosure of information, anti-corruption, taxation, labour relations, environment, and consumer protection. Governments of the countries adhering to the Guidelines agree to promote their implementation by enterprises operating in or from their territory. Used by MNEs from the OECD group of 30 countries plus Argentina, Brazil, Chile, Estonia, Israel, Lithuania and Slovenia
US Securities and Exchange Commission	Requires appropriate disclosure of environmental impacts and expenditure on control facilities and legal proceedings on environmental matters	Sweden's Accounting Standards Board	Provides guidelines on environmental reporting in the Directors' section of the annual report.
US Toxic Release Inventory	Requires companies with more than ten employees to submit data on specific toxic chemicals to the Environmental Protection Agency.	UK Public Environmental Reporting Initiative	Provides tools for organisations to produce a balanced perspective on their environmental policies, practices and performance.
		United Nations Global Compact	Encourages companies to adhere to ten guiding principles in the areas of labour, human rights, environment and anti-corruption.
		US Enhanced Business Reporting Consortium	Encourages increased transparency in business reporting, e.g. "Better Information Leads to Better Management . . . Better Governance . . . Better Markets". Proposes the EBR framework which is intended to put structure around external reporting of information not currently covered under GAAP (i.e. management strategy and plans, risks and opportunities faced by a company, industry-specific, process-oriented value drivers and financial and non-financial key performance indicators).

7.2. Challenges

Despite the increase in national and international codes of conduct and the trends towards standard setting, discussed in the previous section, there are still significant challenges to advancing the uptake of EPM.

These challenges may be perceived from the perspective of users external to organisations, be they capital market investors, customers, future employees or others, and stakeholders internal at the organisation, be they board members, company directors, managers or others. Certain challenges are generic across both stakeholder categories. Figure 9 is illustrative.

Figure 9: Challenges to EPM



7.2.1 Challenges Facing External Stakeholders

External stakeholders, be they customers, investors, suppliers, public sector agents or others, face three main challenges to advancing the uptake of EPM.

Validity, Objectivity and Accuracy of Extended Performance Information

Possibly the greatest barrier is the lack of assurance of the validity, objectivity and accuracy of extended performance information. Contrary to financial accounts, extended performance information is reported on a voluntary basis. This poses questions as to whether external stakeholders can be assured that the information reported in extended performance accounts is accurate and complete. The lack of assurance has created some scepticism among public users, who maintain there is a tendency towards “cheery picking”, whereby organisations turn performance information into a glamorous marketing collateral focusing solely on the success stories, leaving out the negative stories.

In an effort to counter this, the past three years have witnessed the introduction of two new global assurance standards intended to help improve the validity, accuracy and reliability of extended performance information. The two standards, which guide the work of assurance providers, include:

- the International Standard on Assurance Engagement issued by the International Auditing and Accounting Standards Board in December 2003. The standard strives to ensure that assurance is carried out with independence and professionally; and
- the AA1000 Assurance Standard issued by AccountAbility in March 2003. This standard

requires assurance providers to report their findings against the three principles of materiality, completeness and responsiveness.

However, despite the advancement of global assurance standards, the uptake of assurance still remains low in relative terms, both internationally and in Australia. A survey commissioned by CPA Australia (2005), which investigated the level of sustainability reporting among Australian private (top 500) and public sector (Commonwealth and state government business enterprises and local governments) organisations, found that only thirteen (54 percent) of separately disclosed reports had been subjected to any form of audit or verification. A global survey by KPMG (2005) of the top 250 Global Fortune companies shows a more positive number and finds that reports with formal assurance reached 30 percent in 2005, up from 29 percent in 2002.

Incomparability of Information across Organisations, Industries and Time

A second challenge facing external stakeholders is the incomparability of extended performance information across organisations, industries and time. This is influenced by the fragmentation of existing measurement and reporting systems and the lack of standard reporting criteria and frameworks to guide the disclosure of extended performance information. The Global Reporting Initiative (GRI) by the United Nations is increasingly seen to pave the way at an international level for advancing consistency in reporting criteria, with 40 percent of companies in the Global Fortune 250 using the GRI to decide on reporting content (KPMG, 2005).

Availability of Information

The third challenge is the lack of consistency in the availability of extended performance information. Since most disclosure is done on a voluntary basis, the type and level of disclosure is discretionary and information availability is subject to the willingness of individual organisations to publicly report extended performance data. The lack of consistency in availability makes identification and comparison across companies difficult.

In regards to the level of disclosure, recent surveys show a positive trend towards an increase in external reporting. KPMG’s (2005) survey of international reporting practices found that 52 percent of the top 250 Global Fortune companies published separate corporate responsibility reports in 2005. This was a positive increase, up from 45 percent in 2002. The survey also shows that there is a change in the type of disclosure with an increase in sustainability information (social, economics and environmental) over earlier years where environmental, health and safety dominated.

In regards to levels of national reporting, the KPMG (2005) survey found that 80 percent of Japan’s and 71 percent of the UK’s top 100 companies published a separate corporate responsibility report. These two countries were far ahead of the next best, Canada (41 percent). Australia ranked 11th, with only 23 percent of companies issuing a stand alone corporate responsibility report.

Besides the KPMG survey, limited data is available on the reporting practices of Australian organisations. The most advanced is the 2005 survey commissioned by CPA Australia, which investigates the level of sustainability reporting in Australia. The survey finds that twenty-four private corporations published separate sustainability reports in 2003, seventeen of those were

in the Materials industry, three in Capital Goods, two in Energy, one in Telecommunication and one in Banking. The report also outlines reporting levels in the public sector and finds limited uptake in separate reporting documentation with only one Commonwealth government business enterprise (GBE) and 3 state GBEs disclosing a separate sustainability report.

It should be noted that the aforementioned surveys focus solely on corporate responsibility reports. Neither of the surveys investigated the use of intellectual capital statements, balanced scorecards, ValueReporting™ statements and other extended performance accounts.

7.2.2. Challenges Facing Internal Stakeholders

Internal stakeholders likewise face a number of challenges to advancing the use and adoption of EPM.

Resource Requirements

An important challenge facing internal stakeholders wishing to engage in EPM is the time, commitment and resources required to successfully identify, analyse, measure and report their knowledge intensive resources and activities. The previous sections of the *Guiding Principles* outlined the proposed management phases and process steps to produce extended performance accounts. Depending on an organisation’s capability levels, embarking on this process may be a challenging and time consuming affair, requiring vision, leadership, commitment and resources.

Competitive Disadvantage Resulting from Greater Transparency

Possibly the greatest challenge facing organisations in advancing external reporting is the fear of disclosing competitively sensitive information to external

stakeholders. Managers are particularly concerned about competitors gaining insights into strategic information, which may disadvantage them in the market.

Competitive intelligence experts reject this concern. They claim that 98 percent of information is available through public channels and extended performance accounts provide limited information which is not already publicly available.

Measurement

The third challenge facing organisations relates to the complexity associated with tracing the value that accrues from investing in knowledge intensive organisational resources and activities, as discussed in section 4.3. Only during recent years have researchers begun to establish empirical support of cause-effect relations between investing into knowledge intensive resource and financial outcomes¹⁷. Measurement techniques and practices are, however, still in the infancy stage and require more empirical testing through research and practice.

7.2.3. Generic Challenges

Internal and external stakeholders share two generic challenges to advancing the uptake of EPM.

Limited Experience and Skills in Preparation, Analysis and Interpretation

The first is the general lack of awareness of extended performance management processes and techniques.

¹⁷ See Roos and Pike (2004, p. 248 onwards) for an overview of trends in measurement theory and a summary of existing measurement methodologies.

Accountants, investors and business managers are brought up with years of training in financial accounting techniques, focusing on quantitative interpretations and analyses of accrual accounting and cash flow information. Yet, less attention is attributed to the qualitative drivers of business performance including understanding the value of knowledge intensive organisational resources. The challenge lies in increasing visibility and awareness of how to identify, analyse, measure and report the value of knowledge intensive organisational resources.

The Lack of Consistency in Reporting Structure, Format and Content

The second generic challenge is the lack of consistency in reporting structure, format and content, possibly influenced by the aforementioned fragmentation of existing measurement and reporting practices and the lack of consistency in reporting criteria. The 2005 survey (p. 19) commissioned by the CPA finds that “there is significant diversity in the format and scope of the sustainability disclosure practices of sample companies notwithstanding that over 70 percent of them operate in the same industry”. The reports concludes that the “diversity of reporting scope and format impedes comparison of environmental and social performance between entities”.

Contrary to financial statements, extended performance accounts, be they intellectual capital statements, balanced scorecards or corporate responsibility reports, are experimental of nature and therefore dissimilar in structure, format and content. Such inconsistency may be attributable to the “early stage” of extended performance accounts in the product life cycle. The accrual accounting system has over 500 years of heritage. Extended performance accounts have barely a couple of decades on the back.

Furthermore, whereas traditional financial accounts require reporting of quantitative data and have specific content requirements and clear, unambiguous reporting structures, extended performance accounts comprise qualitative, often subjective information. Thus, a challenge is how to create consistency in reporting and measurement practices, given the subjective, often value-laded and qualitative nature of intangible, knowledge intensive resources.

7.3. Action Points

The discussions and analyses undertaken throughout this concluding section of the *Australian Guiding Principles* point towards a series of action points in order to advance the notion and uptake of EPM among Australian organisations, policy makers and professional agencies.

The aforementioned report commissioned by the CPA supports this observation and highlights the importance of the establishment and development of new methods and techniques for managing and accounting for organisational performance. The report (2005, p. 19) states that “the inability or reluctance of organisations to modify or develop tools, processes and frameworks through which they can report their direct and indirect economic, social and environmental impacts to stakeholders provides a challenge for the accounting profession and policy makers. In particular there is a need to develop more accessible approaches and guidelines to enable entities to discharge a broader accountability than is currently reflected in reporting practices in the public and private sectors in Australia”. We extend this focus on social, economic and environmental impacts to also include the effective management of knowledge intensive resources internal at organisations.

We propose a number of key action points to help

address these issues and advance the awareness, uptake and proliferation of extended performance accounts among Australian organisations. These action points pertain to:

1. Influencing the development of national and possibly international guiding principles to ensure consistency in reporting structure, format and content and advance the comparability of extended performance measures¹⁸ across organisations, industries and time¹⁹;
2. Advancing the development of assurance standards to improve information validity, objectivity and accuracy;
3. Facilitating research into EPM to examine the:
 - a. Type, and levels of use, of EPM frameworks in Australia, whether for internal management or external reporting purposes;
 - b. Challenges and benefits that accrue to organisations that measure and report the value and performance knowledge intensive organisational resources.

¹⁸ This may involve the establishment of benchmarking studies and criteria to influence the development of standards on extended performance measures.

¹⁹ An example includes the GRI guideline on sustainability reporting, which identifies eleven principles intended to help ensure comparability and reliability. These include: Transparency; Inclusiveness; Completeness; Relevance; Sustainability Context; Accuracy; Neutrality; Comparability; Clarity; Timeliness; and Auditability.

4. Increasing awareness among practitioners, investors and others of how to interpret and analyse extended performance accounts, possibly facilitated by education, conferences, workshops and professional certification;
5. Aiding and influencing public policy makers in setting the agenda for extended performance management.

The *Society for Knowledge Economics* aspires to be the peak body paving the way for the realisation of these action points.

We invite government officials, public and private sector organisations, industry bodies and professionals to work with us in advancing the position of Australia as a leading knowledge economy within the international community. We are particularly interested in extending an invitation to public and private sector organisations to participate in testing these draft *Guiding Principles on Extended Performance Management*.

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Appendix A: The UK Operating and Financial Review

The UK Department of Trade and Industry has issued a mandatory statutory requirement which requires public listed UK companies to prepare and disclose an ‘operating and financial review’ (OFR) as part of their annual reports. The mandate came into effect in April 2005. The UK Accounting Standards Board is responsible for the statutory requirements of the OFR.

The OFR has been designed to help shareholders get a more complete picture of a company’s business by enabling them to assess a company’s strategies and the potential of them to succeed.

The OFR is intended to strengthen corporate Britain. The idea is that investors equipped with higher-quality information are able to make better informed decisions.

The OFR mandates UK organisations to report on:

- The nature of the market including environmental, competitive and regulatory factors and developments;
- Risks and uncertainties that may affect the entity’s long term value;
- Business objectives, and strategies for achieving the objectives;
- Stakeholder relations which are likely to influence the performance of the business (to the extent necessary);
- Social and community issues (to the extent necessary);
- Environmental matters (to the extent necessary);
- Employees (to the extent necessary);
- ‘The KPIs (key performance indicators), both financial and, where appropriate, non-financial, used by the Directors to assess progress against their stated objectives’ (to the extent necessary) (ASB, 2005, p. 14, paragraph 40). Examples of KPIs are provided in the report and include, among others, customer churn, social risk in the supply chain, employee morale, products in the development pipeline, waste, environmental issues and market share (see p. 50 onwards); and

- Other performance indicators (to the extent necessary).

The mandate states (pp. 7–18):

- The OFR shall have a forward-looking orientation, identifying those trends and factors relevant to the members’ assessment of the current and future performance of the business and the progress towards the achievement of long-term business objectives.
- The OFR shall complement as well as supplement the financial statements, in order to enhance the overall corporate disclosure.
- The OFR shall be comparable over time.
- The OFR shall provide information to assist members to assess the strategies adopted by the entity and the potential for those strategies to succeed. The key elements of the disclosure framework necessary to achieve this are:
 - The nature of the business, including a description of the market, competitive and regulatory environment in which the entity operates, and the entity’s objectives and strategies;
 - The development and performance of the business, both in the financial year under review and in the future; and
 - The resources, principal risks and uncertainties and relationships that may affect the entity’s long-term value.
- To the extent necessary to meet the requirements set out in paragraph 28 above, the OFR shall include information about:
 - Environmental matters (including the impact of the business of the entity on the environment);
 - The entity’s employees;
 - Social and community issues;
 - Persons with whom the entity has contractual or other arrangements which are essential to the business of the entity;

- receipts from, and returns to, members of the entity in respect of shares held by them; and
 - All other matters the directors consider to be relevant.
-
- o The OFR shall include a description of the business and the external environment in which it operates as context for the directors' discussion and analysis of performance and financial position.
 - o The OFR shall discuss the objectives of the business to generate or preserve value over the longer-term.
 - o The OFR shall set out the directors' strategies for achieving the objectives of the business;
 - o To the extent necessary to meet the requirements set out in paragraph 28 above, the OFR shall include the key performance indicators, both financial and, where appropriate, non-financial, used by the directors to assess progress against their stated objectives.
 - o Directors shall also consider the extent to which other performance indicators and evidence shall be included in the OFR.
 - o The OFR shall analyse the main trends and factors that directors consider likely to impact future prospects.
 - o The OFR shall include a description of the resources available to the entity and how they are managed.
 - o The OFR shall include a description of the principal risks and uncertainties facing the entity, together with a commentary on the directors' approach to them.
 - o To the extent necessary to meet the requirements set out in paragraph 28 above, the OFR shall include information about significant relationships with stakeholders other than members, which are likely, directly or indirectly, to influence the performance of the business and its value.

Appendix B: Keizai Doyukai’s White Paper on Corporate Social Responsibility

Prepared by: Nicholas Kearns, University of New South Wales

‘Keizai Doyukai’ (Japanese association of corporate executives) has issued its 15th Corporate White Paper on Corporate Social Responsibility (CSR) management. Japanese companies started to engage with CSR management and reporting in 2003, following the spate of corporate misfeasance and collapses, such as Yamaichi Securities and Hokkaido Takushoku Bank. Simultaneously, Socially Responsible Investment (SRI) funds, which evaluate companies on their environmental performance, social contributions, employment and consumer relations, have started to emerge in the capital market sector.

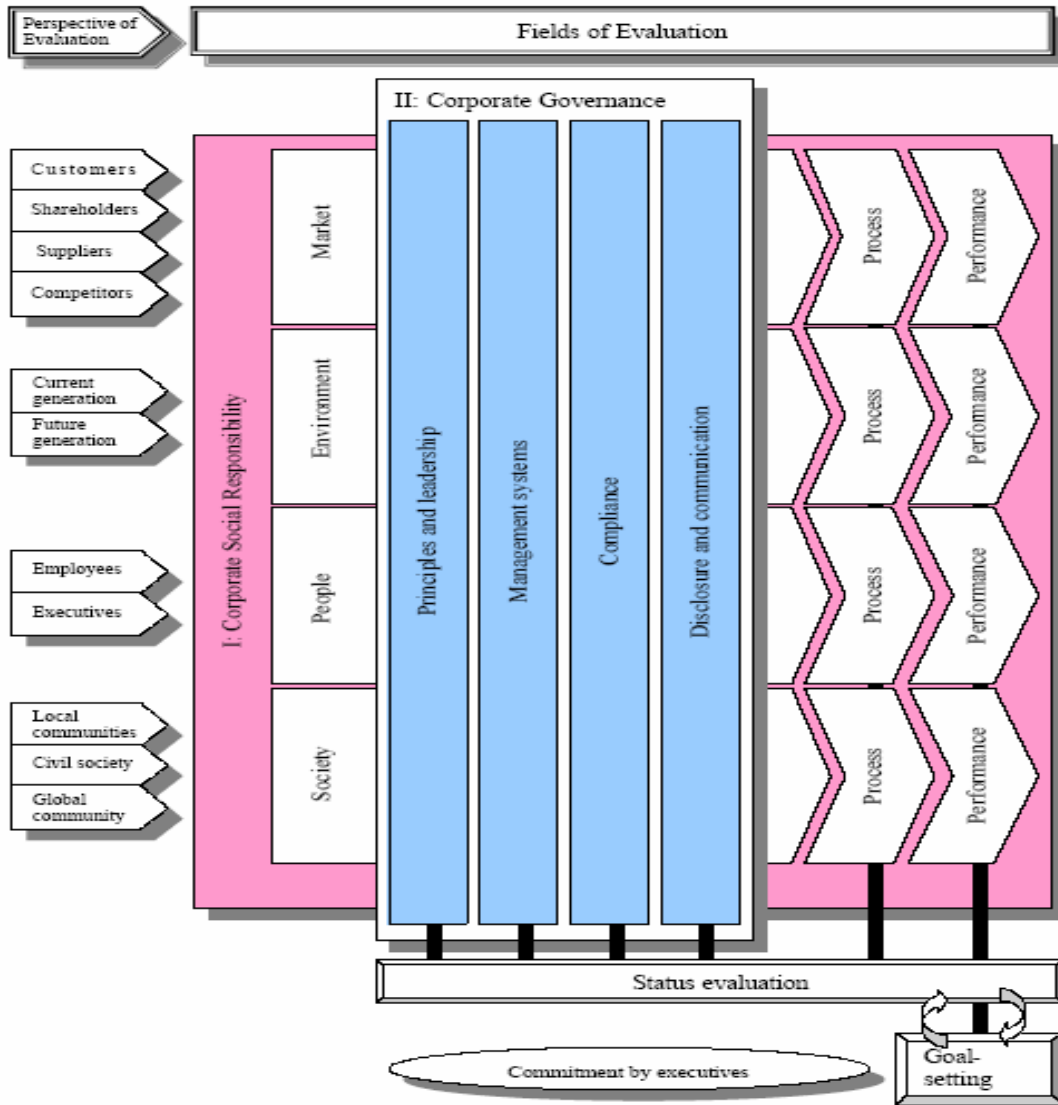
Keizai Doyukai highlights that there are three approaches to CSR in Japan:

- Corporate Ethics Approach – places corporate ethics at the centre of CSR.
- Stakeholder Approach – central issues are accountability to stakeholders, transparency and fairness.
- Sustainability Approach – meet the needs of today without sacrificing the ability of future generations to satisfy their own needs.

Keizai Doyukai’s White Paper proposes a draft CSR standard called ‘Practical Tools for Evaluating the Current Situation and Setting Goals to Enhance Comprehensive Corporate Value’. The aim of the standard is to assist in performance evaluation, goal setting, discovery of best practices and risk management (p. 22). The standard is not exclusively intended for external reporting, but focuses on management principles to enhance sustainability.

The standard outlines 110 CSR indicators, which are grouped into five categories: Market, People, Environment, Society and Corporate Governance, as shown in the figure below. The following table illustrates in more detail the processes and performance indicators deployed to analyse, manage and report organisational practices in the five aforementioned categories.

Components of the CSR Standard



Source: Keizai Doyukai website: <http://www.doyukai.or.jp/en/policyproposals/>

Overview of Processes and Performance Indicators in CSR Standard

I: Corporate Social Responsibility (CSR)	
1. Market	
(Process)	(Performance)
<p>Initiatives for sustained value - creation and creation of new markets</p> <ol style="list-style-type: none"> 1) core competence management 2) marketing 3) collaboration in knowledge 4) intellectual property strategies 5) brand management <p>Providing value to customers</p> <ol style="list-style-type: none"> 6) customer satisfaction survey 7) complaint management 8) risk & crisis management 9) privacy policy <p>Providing value to shareholders</p> <ol style="list-style-type: none"> 10) IR division 11) IR feedback 12) general meeting of shareholders <p>Free, fair and transparent transactions and competition</p> <ol style="list-style-type: none"> 13) fair trade policy 14) CSR procurement standards 15) rigorous compliance with fair trade and fair competition) 	<p>Initiatives for sustained value - creation</p> <ol style="list-style-type: none"> 1) profitability 2) productivity 3) number of patents registered <p>Providing value to customers</p> <ol style="list-style-type: none"> 4) customer satisfaction level <p>Providing value to shareholders</p> <ol style="list-style-type: none"> 5) earnings per share 6) total market value of shares 7) performance forecasts and percentage gap to actual performance <p>Building trust</p> <ol style="list-style-type: none"> 8) number of violations of laws and ordinances concerning consumers 9) number of violations of laws and ordinances concerning fair trade and fair competition
2. Environment	
(Process)	(Performance)
<p>Establishment of environmental management system</p> <ol style="list-style-type: none"> 1) policies 2) employee education 3) acquisition of external certifications 4) environmental accounting <p>Initiatives for reducing environmental burden</p> <ol style="list-style-type: none"> 5) resource saving 6) recycling 7) energy saving 8) assessment of products and services 9) green purchases and procurement <p>Disclosure and communications</p> <ol style="list-style-type: none"> 10) environmental reports 11) third-party environmental review 12) social contribution activities 	<p>Establishment of environmental management system</p> <ol style="list-style-type: none"> 1) acquisition of external certifications <p>Initiatives for reducing environmental burden</p> <ol style="list-style-type: none"> 2) total materials use 3) total energy use 4) total water use 5) greenhouse gas emissions 6) total amount of waste 7) ratio of recycled and re-used resources 8) green purchases and procurement ratio 9) production and sales ratio of eco-friendly goods and services <p>Building trust</p> <ol style="list-style-type: none"> 10) Number of violations of environmental laws and ordinances)

3. People	
(Process)	(Performance)
<p>Employing and utilizing highly skilled and competent personnel</p> <ol style="list-style-type: none"> 1) equal opportunity 2) internal recruitment and FA systems 3) capacity and performance assessment <p>Improving employability</p> <ol style="list-style-type: none"> 4) education and training 5) leadership programs <p>Creating a family-friendly work environment</p> <ol style="list-style-type: none"> 6) consideration of family responsibilities 7) support for child care and long-term nursing care <p>Creating a pleasant work environment</p> <ol style="list-style-type: none"> 8) employee satisfaction survey 9) flexible working hours and styles of employment, consideration of safety, sanitation and human rights) 	<p>Employing and utilizing highly skilled and competent personnel</p> <ol style="list-style-type: none"> 1) ratio of female directors 2) ratios of female managers 3) ratio of foreign managers in domestic offices 4) ratio of foreign directors in overseas offices 5) ratio of employees with disabilities <p>Improving employability</p> <ol style="list-style-type: none"> 6) amounts spent for employee education and training) <p>Creating a family-friendly work environment</p> <ol style="list-style-type: none"> 7) annual paid holidays used 8) monthly hours of overtime 9) number of employees using leave of absence for child-rearing 10) number of employees using leave of absence to provide long-term nursing care) <p>Creating a pleasant work environment</p> <ol style="list-style-type: none"> 11) level of employee satisfaction)
4. Society	
(Process)	(Performance)
<p>Promoting activities for contribution to society</p> <ol style="list-style-type: none"> 1) basic policy 2) utilizing management resources and special strengths 3) supporting the volunteer activities of employees <p>Disclosure and partnership</p> <ol style="list-style-type: none"> 4) sustainability reports 5) dialogue and collaboration with NGOs and NPOs) <p>Establishing proper relations with politics and government</p> <ol style="list-style-type: none"> 6) Relations with politics and civil servants <p>Cooperation with global community</p> <ol style="list-style-type: none"> 7) observing international rules and norms observing local laws, culture and practices 8) contributing to solution of global problems 	<p>Promoting activities for contribution to society</p> <ol style="list-style-type: none"> 1) amount expended 2) number of student interns accepted 3) number of employees taking advantage of system of holidays and leave of absence of volunteer work 4) number of collaborations with NGOs and NPOs <p>Building trust</p> <ol style="list-style-type: none"> 5) number of violations of laws in connection with domestic politicians and civil servants 6) number of violations of laws in connections with foreign politicians and civil servants

II: Corporate Governance (CG)	
1. Principles and Leadership	2. Management Systems
<p>Clear and transparent management principles</p> <ol style="list-style-type: none"> 1) efforts for clarification and transparency 2) level of clarification of stakeholders 3) transparency of stakeholders <p>Exercise of leadership</p> <ol style="list-style-type: none"> 4) direct participation by CEO 5) communication with employees 6) communication from employees 	<p>Functional powers of board of directors and board of auditors (or auditors)</p> <ol style="list-style-type: none"> 1) participation in real discussion 2) integration of external perspectives 3) opinions of auditors/board of auditors 4) support given to auditors <p>Appointment and assessment of CEO</p> <ol style="list-style-type: none"> 5) appointment 6) assessment and removal 7) decisions on remuneration <p>Establishment of CSR-related management systems</p> <ol style="list-style-type: none"> 8) creation of CSR office 9) SRI of pension funds
3. Compliance	4. Disclosure and Communication
<p>Formulation and education of corporate code of conduct</p> <ol style="list-style-type: none"> 1) formulation and publication 2) education 3) application or recommendation to group companies <p>Establishment of compliance system</p> <ol style="list-style-type: none"> 4) creation of compliance office 5) consultation and advisory desk 6) internal complaints desk 7) checking of compliance status 8) inclusion in performance assessment 	<p>Establishment of management systems for promoting disclosure and communication</p> <ol style="list-style-type: none"> 1) basic policy 2) scope and contents of disclosure 3) feed-back 4) dialogue with stakeholders

Source: Keizai Doyukai website: <http://www.doyukai.or.jp/en/policyproposals/>

The Keizai Doyukai gives the following reasons as to why Japanese companies need to re-examine their social responsibilities:

- Growing mutual influence of business and society.
- Society’s changing (more critical) view of the corporation.
- Rectifying the excesses of ‘shareholder capitalism’.
- Changing individual values.

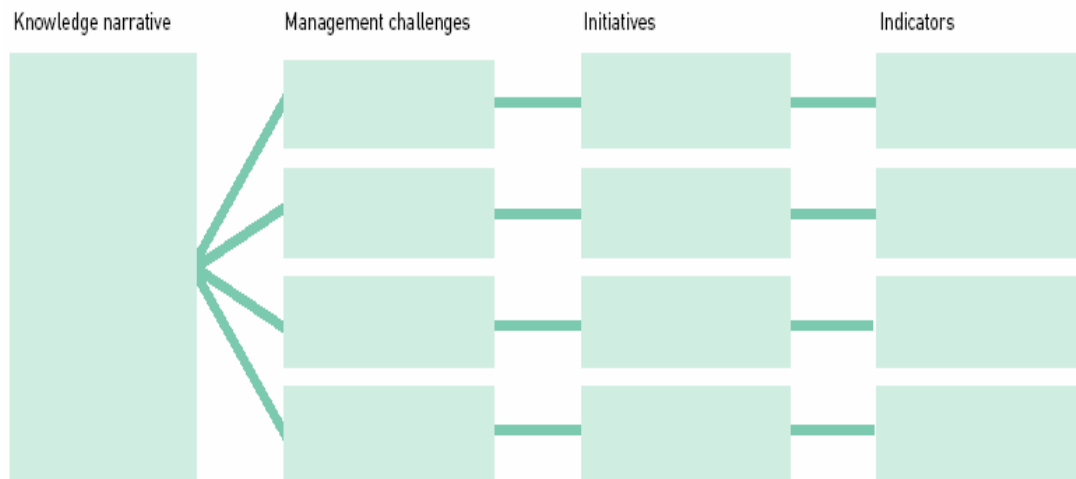
Appendix C: Danish Guideline on Intellectual Capital Reporting

The Danish Ministry of Science, Technology and Innovation published two guidelines on intellectual capital (IC) reporting in 2003. The first guideline informs organisations on how to prepare IC reports. The second guideline informs users on how to read and analyse IC reports. The guidelines were piloted by more than 150 Danish organisations over a five-year period.

The first guideline consists of five parts, as follows:

Part 1 outlines the elements of the IC statement and provides examples of how an IC statement looks and is structured. It introduces the IC statement model which consists of four categories as illustrated in Figure 5 below.

Figure 5: Mouritsen et al.’s (2003) IC Statement Model



Source: Mouritsen et al. (2003) in conjunction with the Danish Ministry of Science, Technology and Innovation 'Intellectual Capital Statements – the New Guideline'

The **Knowledge Narrative** explains:

- What product or service does the company provide?
- What makes a difference for the consumer?
- What knowledge resources are necessary to be able to supply the product or service?
- What is the relationship between value and knowledge resources?

The **Management Challenges** detail:

- What challenges is the organisation experiencing?
- Which existing knowledge resources should be strengthened?
- What new knowledge resources are needed?

The **Initiatives** detail the actions taken by management to overcome the management challenges:

- What initiatives can be launched?
- What initiatives should be prioritised?

The **Indicators** measure the effectiveness of the knowledge management initiatives:

- Which indicators can each initiative have? Indicators can measure:
 - Effects;
 - Activities; and
 - Resource mix.

Part 2 describes in more detail how to prepare an IC statement. It outlines how to populate the four elements in the reporting model and how to identify, build, develop and anchor a company’s knowledge resources.

Part 3 provides directions on how to communicate and write IC statements to external stakeholders. It raises questions such as:

- Who is the target audience?
- What is the principle message?
- Which media to use? Should the IC statement be part of the annual report or separate?
- What are the legal requirements?
- What are the resource allocations (time and cost / man hours, etc.)?

Part 4 outlines the work process involved in preparing an IC statement and provides suggestions for how to organise the IC project and project team.

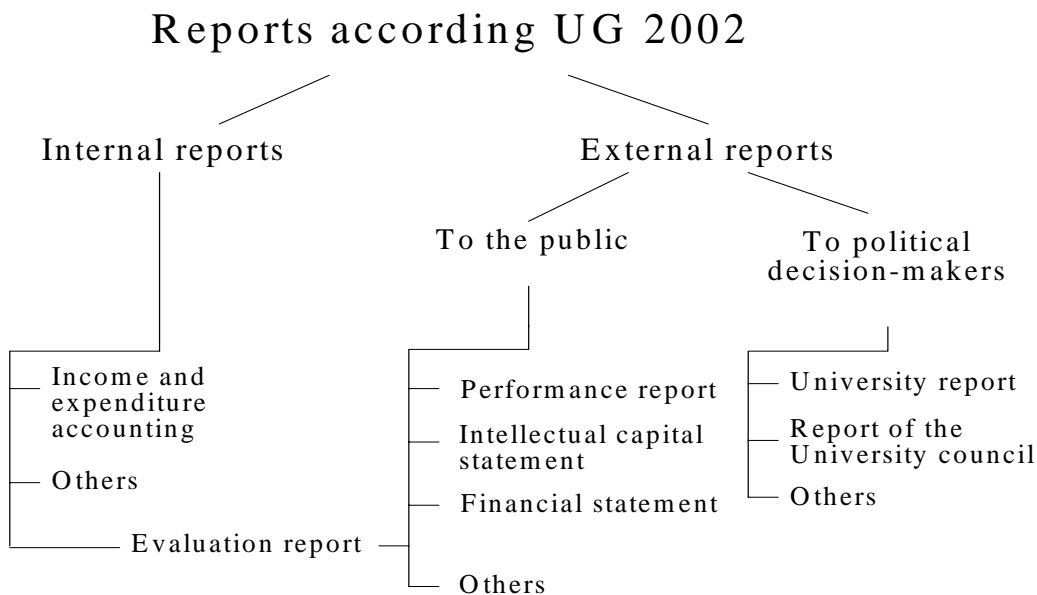
It raises questions such as:

- Who is part of the project team?
- What is the role of senior management?
- What is the time schedule and deadline?
- How to ensure management commitment?
- How can data collection be automated?
- Is there a need for an auditor’s verification?
- How is the IC statement used as a management tool in practice?
- How can the company ensure the IC statement will become embedded in the organisation?
- Is there an opportunity to participate in Experience Groups where companies come together to brainstorm, share ideas and knowledge on how to prepare an IC statement?

Appendix D: Austrian University Act

On 1 January 2004, the University Organisation and Studies Act came into effect for all state universities in Austria. The act mandates Austrian universities to produce intellectual capital reports (see Figure 1 below). The act is part of a government initiative taken to restructure the educational and legal framework of universities.

Figure 1: Reports According to the Austrian University Organisation and Studies Act



Source: Schaffhauser-Linzatti (2004)

The purpose of the IC statement (Schaffhauser-Linzatti, 2004, pp. 2–6) is as follows:

- The IC statement is designed as an inventory of the existing intellectual capital within the university.
- Knowledge, or similar intellectual capital, is the most relevant production factor for universities and hence should be made visible.
- The new reporting system enforces transparency inside and outside universities.
- Externally, the IC statement shall represent a possibility to publicly account for the use of tax money and to publish the university's performance.

- Internally, it shall deliver information for management and control.
- The statement serves as an important basis for the university’s budgetary reimbursement; the IC information will inform performance-oriented budget allocation from the Federal Ministry and from private institutions.

The IC statement is (envisioned) to contribute to:

- Reallocation and a more effective and efficient use of resources;
- improvement in management decision making and forecasting; and
- enforcing competition on public and private resources, resulting in an increase in the performance of Austrian universities.

Content and Structure (pp. 13–14):

- The IC statement is structured into human, structural and relationship capital.
- Human capital is defined as the knowledge of the academic and non-academic staff that is relevant to perform all university tasks; structural capital as non-personal equipment; and relationship capital as networks of social relations that support universities’ performances and help acquire knowledge from outside the university (article 12 (11) RV).
- For each category, an obligatory set of ratios is enlarged by specific sets for defined fields of studies and research (i.e. medicine or arts). Further ratios may be added voluntarily. A verbal interpretation allows for evaluating the ratios and for embedding them into the university’s strategy.
- Examples include:
 - Human capital: number of academic staff.
 - Structural capital: available m².
 - Relationship capital: partnerships with other universities.

Appendix E: ASX Principles of Good Corporate Governance and Best Practice Recommendations

Prepared by: Cameron Barnsley, University of New South Wales

In March 2003, the recently formed ASX Corporate Governance Council released a report entitled 'Principles of Good Corporate Governance and Best Practice Recommendations', with the primary aim of providing a comprehensive guide to listed entities and their external stakeholders as to best practices in corporate governance and disclosure. The report emphasises the need for corporate accountability and transparency by promoting the disclosure of corporate governance practices, but does not dictate 'black letter' disclosure – instead, the report provides guidance to listed entities as to what disclosures should be made. These guidelines are supported by ASX Listing Rule 4.10.3, which requires that listed companies must provide '[a] statement disclosing the extent to which the entity has followed the best practice recommendations set by the ASX Corporate Governance Council during the reporting period'. If the entity has failed to follow one or more of the recommendations, a disclosure must be made outlining the reasons why the company has failed to comply.

There are ten Corporate Governance Principles which are dealt with by the report. The following is a brief description of the principles, making specific reference to any issues surrounding the disclosure of non-financial information. Emphasis is placed on any non-financial disclosures which form part of the principles.

- **Solid Foundations for Management and Oversight:** In terms of disclosure, this principle focuses on the division of responsibility and contributions of the board and senior management of a particular entity. Such disclosures, it is argued, will help promote greater understanding by financial report users of the accountabilities and contributions of individual parties within the board and the management structure. The recommendation also suggests that a 'statement of matters reserved for the board or a summary of the board charter or the statement of delegated authority to management' should be disclosed by the entity.
- **Structuring the Board to Add Value:** This principle focuses on the independence of directors and structuring the board to ensure that it adequately discharges its duties to shareholders. Disclosure of the independence of directors is recommended to be made in the Annual Report, in addition to the tenure (or the period of office) of each director. In addition, the recommendations suggest an independent Chairperson and a separation of the roles of the Chairperson and the Chief Executive Officer, as well as the establishment of a Nomination Committee. Relevant disclosures which form part of the recommendation include the following:
 - The relevant skills, experience and expertise of directors.
 - The independence of directors, including the company's materiality thresholds with reference to independence.

- Whether there exists a procedure by which directors can seek professional advice at the expense of the company.
 - The term of office of each director.
 - The members and attendance records of the Nomination Committee.
 - A description of the procedure for the appointment of new directors.
 - The charter of the Nomination Committee (summarising the role, rights and responsibilities of members).
 - The Nomination Committee’s policy for appointment of its members.
- Promoting Ethical and Responsible Decision Making: This recommendation emphasises the need for the board of a publicly listed company to establish a code of professional conduct, and a policy in relation to the trading activity of employees and directors. Disclosure of these two policies should be made in the Annual Report of the entity.
 - Safeguarding the Integrity of Financial Reporting: The fourth principle focuses on mechanisms and review structures to ensure the truthful and factual reporting of an entity’s financial position and performance. In addition to a requirement for the CEO and CFO to report to the board regarding the truthfulness and fairness of a company’s financial reports (which has now been legislated under the *Corporations Act 2001* (Commonwealth) as part of the CLERP 9 reform package), the recommendation focuses on the establishment of an Audit Committee which should report to the Board of Directors. In terms of disclosure, the recommendation suggests detailed disclosure about the membership and functions of the Audit Committee, the attendance records, as well as information about the committee’s charter and appointment mechanisms.
 - Timely and Balanced Disclosures: This recommendation emphasises compliance with ASX Listing Rules by introducing mechanisms which ensure equal and timely access by investors to market disclosures. In terms of non-financial disclosure, this recommendation requires a summary of the policies and procedures which the company has in place to ensure compliance with the disclosure requirements of the ASX Listing Rules.
 - Respecting the Rights of Shareholders: It is argued that a company has the obligation to empower its shareholders through open and effective communication, balanced and understandable information about the organisation and future proposals, ensuring that shareholders are able to participate effectively at General Meetings. In terms of disclosure, this recommendation suggests that an entity should describe the arrangements it has in place to promote communication with shareholders within the corporate governance section of its Annual Report.

- **Recognising and Managing Risk:** The seventh recommendation includes a requirement for listed entities to put in place systems which identify, assess and monitor organisational risk, and inform the public about changes in the entity’s risk profile. A description of such systems and procedures is required within the corporate governance section of an entity’s Annual Report.
- **Encouraging Enhanced Performance:** This recommendation involves the encouragement of enhanced board and management effectiveness, and the review of individual and collective performance. As with the previous recommendation, in terms of non-financial disclosure, all that is required is a description of the process for performance evaluation of board members and senior management.
- **Fair and Responsible Remuneration:** In order to achieve corporate governance best practice, this recommendation mandates disclosure in relation to remuneration policies and reporting the link between corporate performance and executive and director remuneration. The key disclosures which are to be made under this recommendation include:
 - The company’s remuneration policies;
 - details of the company’s Remuneration Committee;
 - the existence and terms of any schemes for retirement benefits (other than statutory superannuation) for non-executive directors; and
 - the charter of the Remuneration Committee, including the rights, responsibilities and roles of members.
- **Recognising the Legitimate Interests of Stakeholders:** This final recommendation identifies that companies have wider responsibilities beyond shareholders which extend to employees, customers and the wider community. The report states that organisations should establish, and disclose the existence of, a code of conduct in relation to its legal and other obligations to stakeholders. The report provides guidelines for such a code, and such guidelines must be disclosed in the corporate governance section of an entity’s Annual Report.

In addition, in line with the CLERP 9 regulatory changes, ASX Listing Rule 12.7 now requires that companies included in the S&P All Ordinaries Index must have an Audit Committee attached to their Board of Directors. This committee must follow the Corporate Governance Best Practice Recommendations if the relevant entity is amongst the top 300 listed entities at the beginning of its financial year.