

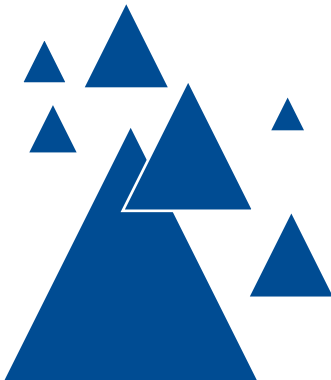
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# Intellectual Capital Reporting: Lessons from Hong Kong and Australia

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## Executive Summary



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# **E**XECUTIVE SUMMARY

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## **Introduction**

Around the world many organisations claim to be investigating the potential for reporting information on intellectual capital (IC) beyond that required to meet conventional financial accounting standards. Collectively, their efforts have precipitated the re-emergence of a long-standing debate about whether or not to report values for internally generated, as opposed to purchased, intangible assets in financial statements, and have framed that debate in new ways.

Although the focus of this study is on the firm level, there is also evidence to support the assertion that intellectual capital is instrumental in driving national economic performance. This is probably because many nations have transformed their economy from an industrial base to a knowledge economy. In line with a shift in the type of businesses populating most developed economies, from capital intensive to knowledge intensive, and moves to challenge the existing financial model, by making intangibles part of the dialogue, it is expected that companies in Asia will make greater efforts to report on their intellectual capital in much the same way as some companies in Europe have been doing.

The fact that traditional financial reporting practice does not include non-financial performance adversely impacts knowledge-based organisations. Those that are looking to raise capital in the debt and/or equity markets are particularly affected. 'New' intangibles and their value, such as staff competencies, customer relationships and computer and administrative systems, receive little recognition in traditional financial reporting models. Even traditional intangibles, like brand equity, patents and goodwill, are reported in the financial statements only when they meet stringent recognition criteria. They are otherwise omitted from the financial statements.

The invisibility of intellectual capital has led to calls from regulators and practitioners, as well as academics, for intellectual capital information to be disclosed in company annual reports via management commentary or in separate intellectual capital reports. This realisation is underscored by observers, who argue that organisations need to go beyond disclosing just financial performance metrics and also report non-financial indicators, so that a more balanced approach to performance can be found.

This study investigates the voluntary disclosure of companies located in both Australia and Hong Kong, and their intellectual capital attributes. The study uses content analysis to analyse annual reports in order to determine intellectual capital disclosure levels. An earlier review by Guthrie and Petty (2000) revealed that annual reports were a key communication tool to legitimise corporate activity. However, when performing content analysis, the impact of size is commonly assessed and this size effect on voluntary disclosure practices is also examined in line with the exploratory mission of this study.

In addition, this research monograph extends the literature on cross-border comparisons of intellectual capital reporting (ICR) practices and identifies the differences in the types of reporting and the variation in reporting frequency of companies voluntarily reporting.

The types of IC reporting investigated are: external capital; internal capital; and human capital. The results indicate that, on average, Australian companies disclose a greater amount of IC information than Hong Kong companies. However, in both countries, nearly every instance of ICR is expressed in discursive rather than numerical terms. An examination of the content of the disclosure reveals a relevant change in the pattern of disclosure. The results of a previous Australian study (Guthrie and Petty, 2000) and Hong Kong study (Petty, 2003) showed that the information disclosed was evenly distributed across the intellectual capital categories. In this study, in Australia, the internal and external capital categories now account for the majority (90%) of the IC reported. The human capital category is, by comparison, significantly less reported (10%) and the external capital category accounts for almost half of the observed reporting practices (49%). Interestingly, Hong Kong companies are disclosing, in

percentage terms, more information on human capital than Australian, and even European, companies.

In conclusion, this study examines the voluntary reporting of IC using Hong Kong and Australian data. It reveals that levels of intellectual capital disclosure are relatively low. Further, the results indicate that, where there is disclosure, it is mainly expressed qualitatively rather than quantitatively. Finally, the level of disclosure is positively related to company size, a finding that is consistent with the previous literature on voluntary reporting.

The research monograph also considers the implications for policy setters. It is recognised that there is value in the disclosure of intellectual capital information and that practice is leading policy in this field. The current policy vacuum in intellectual capital reporting has resulted in a lack of standardisation of reporting. However, any future guidelines will need to be flexible to accommodate the dissimilarities in organisation type and reporting.

Developments in intellectual capital reporting are currently being led by practice rather than policy. Questions arise as to how ICR policy can be developed. The profession should be actively involved in this development, establishing a shareholder taskforce. This taskforce should: facilitate the participation of stakeholders; help finance research on the management and disclosure of intangibles; and encourage the development of voluntary guidelines and reporting systems.

Further research is required to establish a consensus between business and researchers, about the need to report, what to report and how to report it. To support this, research should be undertaken to identify what is driving the voluntary disclosure of intellectual capital reporting and to obtain evidence of best-practice models of intellectual capital reports.

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