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The Project of Intellectual Capital Disclosure: Researching the Research

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Keywords

Australia, Ireland, Italy, intellectual capital, intellectual capital disclosure, Sri Lanka

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**THE PROJECT OF INTELLECTUAL CAPITAL DISCLOSURE:
RESEARCHING THE RESEARCH**

by

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This paper examines a number of key issues relating to intellectual capital (IC) disclosure by addressing some of the strengths, weaknesses and gaps of the extant research. The paper begins by examining the definitions of intellectual capital and intellectual capital disclosure currently in use. Methodological issues are examined in relation to the use of source documents, coding frameworks, and research methods. Both positivist and critical theoretical perspectives used to provide a theoretical underpinning of IC disclosure analysis are reviewed. The paper concludes by arguing for the importance of addressing these issues in order to improve the credibility of IC disclosure, and offers suggestions for doing so.

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1. INTRODUCTION

The intellectual capital (IC) held by a firm can be thought of as a form of ‘unaccounted capital’ within the traditional accounting system. This ‘unaccounted capital’ can be described as the knowledge-based equity that supports the knowledge-based assets of a firm. The traditional accounting system focuses largely on severable assets (Leadbeater, 1998), though recognition is given to some IC items in the form of goodwill (Davies and Waddington 1999). With the increasing abundance of knowledge-based products and services in the global economy, a vacuum has been created within traditional accounting regarding the recognition of knowledge-based assets (Tissen, Andriessen and Deprez, 2000, p. 53). A study involving top executives from both the Canadian Financial Post 300 firms and U.S. Fortune 500 firms has revealed the importance that they place on identifying, measuring and managing their intangible assets or IC base. These executives indicated that assets such as know-how, company and product reputation, and relational databases contribute to the success of corporations (Stivers, Covin, Hall and Smalt, 1997). Studies carried out in other developed nations have supported these findings (Fruin, 1997, pp. 200-201).

One of the most important factors that has highlighted the importance of IC within the firm is the shift in the focus of management from tangible to intangible capital when considering the ‘value creation’ processes within firms. According to Mouritsen, Larsen and Bukh (2001), value creation is the process of transforming or improving corporate

routines and practices. This shift in focus from tangible to intangible assets has also been observed among users of accounting information, which has further accentuated the importance of IC disclosure. For instance, Simister, Roest and Sheldon (1998, p. 2) argue that with the shift in emphasis from tangible to intangible assets, one of the accountant's roles has become to identify, measure and analyse these intangible assets. The accounting profession, in turn, argues that the accountant is responsible for educating all stakeholders about the importance of intangibles, and for reporting results to them (ASCPA and CMA, 1999, p. 108).

Recent studies of IC disclosure have attempted to explore the IC practices of firms through an analysis of company annual reports. Studies that have made a notable contribution in this regard are Guthrie and Petty (2000) in Australia, Brennan (2001) in Ireland, Bozzolan, Favotto, and Ricceri (2003) in Italy, and Abeysekera and Guthrie (2004, 2005) in their study of Sri Lanka.

This paper takes a closer look at the key issues relating to intellectual capital disclosure, with the view to strengthening the research 'project' of IC disclosure. It addresses some of the strengths, weaknesses and gaps within the extant research, and suggests ways to improve the credibility of the research process and its outcome for stakeholders. In doing so, this paper brings in discussions from the Australian, Irish, Italian and Sri Lankan studies. Section 2 briefly examines issues relating to the various definitions of intellectual capital and intellectual capital disclosure currently in use. Section 3 critically reviews the use of methodological issues such as source documents, coding frameworks and research

methods. Section 4 reviews a number of theories cited as being relevant to IC disclosure in the literature. Section 5 offers some concluding remarks regarding ways to improve the credibility of intellectual capital disclosure.

2. INTELLECTUAL CAPITAL DEFINITIONS AND DISCLOSURE

As identified by Petty and Guthrie (2000), the literature offers a number of definitions of intellectual capital. In some definitions, intellectual assets are considered as being synonymous with intellectual capital, and most of those definitions take the view that benefits from IC are not necessarily immediately identifiable, but rather are accrued over a long-term period (ASCPA and CMA, 1999, p. 4; Brooking, 1997; CMA, 1998, p. 3; Edvinsson and Sullivan, 1996; Edvinsson, 1997; Edvinsson and Malone, 1998; Klein, 1998, p. 1; Knight, 1999; Stewart, 1997, p. x; Ulrich, 1998).

Beyond their agreement that the benefits of IC are accrued over a long-term period, however, authors differ regarding the definition of IC (Edvinsson and Sullivan, 1996; Brooking, 1997; Edvinsson, 1997; Edvinsson and Malone, 1998; Stewart, 1997, p. x; Klein, 1998, p. 1; Ulrich, 1998; CMA, 1998, p. 3; ASCPA and CMA, 1999, p. 4; Knight, 1999). For example, Edvinsson and Sullivan (1996), and Petrash (1996), all view intellectual assets as being synonymous with IC. The Society of Management Accountants of Canada (SMAC), on the other hand, offers an accounting based definition (IFAC, 1998, p. 12). The SMAC definition, in turn, conflicts with the assets definition of the International Accounting Standards Committee (IASC) and the Australian Conceptual framework, since SMAC defines assets using the criterion of ownership of the asset,

while others define assets using the criterion of control over the asset (CPA Australia, 2000, pp. 49-69; IAS 38, 1998). This diversity of definitions highlight the need for further debate and effort towards arriving at a uniformity of definitions (ASCPA and CMA, 1999, p. 53), as well as the perhaps even more complex issue of agreement on a generally accepted theory of IC (Canibano, Garcia-Ayuso, Sanchez and Olea, 1999; Petty and Guthrie, 2000; Van der Meer-Kooistra and Zijlstra, 2001).

The definition of IC disclosure, on the other hand, has hardly been debated in the literature. One exception is the definition provided by Abeysekera and Guthrie (2002). Using the definition of general purpose financial reporting as a basis, these authors have defined IC disclosure as “a report intended to meet the information needs common to users who are unable to command the preparation of reports about IC tailored so as to satisfy, specifically, all of their information needs”. Abeysekera and Guthrie’s (2002) definition is adapted from the Australian accounting handbook, which defines general purpose financial reporting as “a financial report intended to meet the information needs common to users who are unable to command the preparation of reports tailored so as to satisfy, specifically, all of their information needs” (ASCPA, 1999, p. 5).

Further, there is a notable diversity in the way IC is defined in IC disclosure studies. Guthrie and Petty (2000) do not offer an explicit definition of IC or IC disclosure, however they do allude to the fact that IC disclosure carries greater importance now than in the past due to the dominant industry sectors shifting from manufacturing to high technology, financial and insurance services. These authors take the view that IC

disclosure varies between industry sectors, however they make no reference to the importance of other factors such as the type of ownership of firms, and shareholder diversity and concentration.

For instance, Bozzolan *et al.* (2003) refer to IC as all information that is perceived as being important for investors and analysts. On the other hand, Brennan (2001) refers to IC as knowledge that is transferred to produce higher valued assets in order to increase the value to a firm. Brennan, in turn, suggests that the value of IC is the difference between the market value and book value of a firm. Abeysekera and Guthrie (2004, 2005) allude to a similar definition when they state that all IC is considered unaccounted capital in the traditional accounting system. It could be argued, therefore, that the market value of a firm is influenced by several factors, some of which are controllable, and others that are not controllable, by a firm. Book value is also influenced by accounting standards, policy guidelines and legislation. If the market to book value represents IC, then intellectual capital should diminish when the share market has fallen in a firm, assuming that such a fall is indicative of diminishing IC value creation in the firm. However, this is not consistent with the definition of value creation offered by Mouritsen *et al.* (2001), who state that value creation is what occurs as a result of the transformation or improvement of corporate routines and practices.

As Martensson (2000) points out, there should be a uniform definition of ICD, since the lack of a uniform definition, and the availability of several definitions, of IC and ICD means that firms are able to define IC and ICD in an *ad-hoc* fashion for disclosure

purposes. The result is to mediate the agendas of debate of the firm through IC disclosure to orchestrate the firm's political, social and economic arrangements or agendas. Therefore the biggest challenge, as stated by Petty and Guthrie (2000), is to reach a consensus on three key questions: the need to report; what to report; and how to report.

The fact that most of the definitions of intellectual capital are based on recognition of intellectual assets is also a matter for concern. The Society of Management Accountants of Canada (SMAC) offers an accounting-based definition for intellectual capital (IFAC 1998:12). As mentioned earlier, this SMAC definition conflicts with the assets definition of the International Accounting Standards Committee (IASC) and the Australian conceptual framework, since SMAC defines assets using the criterion of ownership of the asset whereas others define assets using the criterion of control over the asset (CPA Australia 2000: 49-69; IAS 38 1998). There is also considerable ambiguity as to what constitutes intellectual assets, with some authors including all intangibles (Roos, Roos, Dragonetti, and Edvinsson 1997; Knight 1999), while others do not recognise intangibles in financial statements (Caddy 2000; Edvinsson and Sullivan 1996).

There is another problem related to intellectual capital. While a limited number of studies have demonstrated the possibility of the existence of intellectual liabilities in the constitution of intellectual capital (Abeysekera 2003a; Abeysekera 2003b; Harvey and Lusch 1999; Caddy 2000; Dzinkowski 2000), the presence of intellectual liabilities has been under-estimated or ignored. Previous IC disclosure studies in Australia (Guthrie and Petty 2000), Ireland (Brennan 2001) and Italy (Bozzolan *et al.*, 2003) have not taken into

account the possibility of the existence of intellectual liabilities in their study of IC disclosure. Only Abeysekera and Guthrie (2004; 2005) acknowledge and incorporate both intellectual assets and liabilities as representing IC in their studies of IC disclosure.

The emphasis on intellectual assets rather than on intellectual liabilities may suggest that firms are not disclosing the full extent and nature of their IC in public documents such as annual reports to stakeholders. If this is so, then IC disclosure by firms is a process undertaken to benefit the aspirations of the firm, rather than providing a way of improving the quality of information shared with stakeholders. Indeed, Mouritsen *et al.* (2001) refer to the disclosure of IC in statements as a way of crafting a credible, cohesive, 'true and fair' account of the firm's activities. Mouritsen and his colleagues refer to intellectual capital statements whereas much of the ICD literature is based on a textual analysis of the annual reports. Very few firms produce separate intellectual capital statements. It can be argued that, while crafting IC disclosure in different ways may lead to cohesive reports, it may not necessarily provide a credible set of disclosures of the affairs of a firm. Mouritsen *et al.* state that IC disclosure is communicated to both internal and external stakeholders by combining a numbering, visualisation and narrative account of value creation. This more sophisticated form of IC disclosure, they argue, has become a way of justifying the new roles and obligations of employees within the firm, and how these employees should contribute to value creation. IC disclosure has become a new type of communication that manipulates the 'contract' between labour and management. In so doing, it allows managers to craft strategies that meet the demands of stakeholders such as investors, and to convince stakeholders of the merits of the firm's policies. IC

disclosure in the Danish Guidelines, then, has more to do with stating and steering an agenda of debate preferred by the firm, than with merely presenting a financial report of the firm's activities.

3. METHODOLOGICAL ISSUES

Methodological issues surrounding the research into IC disclosure in company annual reports can be identified in relation to three aspects: the coding frameworks used for analysis; the use of annual reports as source documents; and methodologies employed for data collection. These three issues are discussed below.

Coding framework

An analysis of the literature reveals the following five major IC frameworks: (i) structures holding intellectual assets (Sveiby, 1997, pp. 93, 11-12, 165), which focuses on intellectual assets; (ii) capital holding intellectual items (Edvinsson, 1997; Edvinsson and Malone, 1998; Roos *et al.*, 1997; Edvinsson and Sullivan, 1996), which has been modified by others (Stewart, 1997, pp. 229-246; Roos and Roos, 1997), and where intellectual capital is viewed in relation to intellectual assets; (iii) assets representing intellectual capital (Brooking, 1996, pp. 13-15, p. 129, 1999, pp. 153-155), which focuses on intellectual assets; (iv) strategic root and measurement root (Roos *et al.*, 1997, p. 15), which focuses on the role of intellectual capital; and, finally, (v) a combination of assets and capital representing intellectual capital (SMAC, 1998, p. 14; IFAC, 1998, p. 7; Dzinkowski, 2000).

One of the pioneering studies of IC disclosure was carried out by Guthrie, Petty, Ferrier and Wells (1999), which was presented at an OECD Symposium on measuring and reporting intellectual capital. The findings of this study were later published with further improvements (Guthrie and Petty, 2000). While the authors used the classification of IC proposed by Sveiby in 1997, they renamed the categories of IC as internal capital (instead of internal structure), external capital (instead of external structure), and human capital (instead of employee competence). Several authors studying IC disclosure followed suit in Ireland (Brennan, 2001), Italy (Bozzolan *et al.*, 2003), and Sri Lanka (Abeysekera and Guthrie, 2004, 2005).

The abovementioned studies have highlighted an important phenomenon in their respective countries with regard to IC disclosure by firms. They have confirmed that external capital (i.e. external relations such as with customers) is the most reported IC related item in most annual reports. This emphasis on external capital with a focus on customers once again highlights the way in which firms create value – that is, they emphasise the creation of economic capital (investments, etc) over social capital and human capital. Bukh (2003) supports this approach to value creation, providing a theoretical justification for its perpetuation. Bukh argues that value creation through IC should be analysed with an understanding of who the customers are, what they need, and how value is created for the customers to obtain competitive advantage. However, in reality, this means that firms are ‘facilitating’, or ‘manipulating’, their firm’s true value through the process of IC disclosure. Therefore, it could be argued that the ‘IC project’ is

designed to assist economic capital creation with no regard for other types of capital influencing society and the environment.

Source documents: annual reports

Many IC disclosure studies have used annual reports as a source document for their research (Guthrie and Petty, 2000; Brennan, 2001; Bozzolan *et al.*, 2003; Abeysekera and Guthrie, 2004, 2005). The reason for this is that annual reports are regularly produced and, it is argued, present an historical account of the concerns of a firm, and its management's thoughts, in a comprehensive and compact manner (Niemark, 1995, pp. 100-101).

However, a fact that is not acknowledged in many of the IC disclosure studies that use annual reports as their source document, is that annual reports may not reflect the objective reality of the firm. Empirical findings by Williams (2001) indicate that there is no strong relationship between the amount of IC disclosure in annual reports and the market value of a firm. This is because most listed firms use the annual report as a document to publicise the firm rather than as merely a way of complying with accounting standards and corporate law. Empirical evidence suggests that annual reports provide a special opportunity for firms to communicate more than simply financial information (Cameron and Guthrie 1993), to show leadership and vision in a way that reflects the values and position of the firm (Niemark 1995, pp. 100-101; Clackworthy 2000), and to establish a strong public image (Guthrie and Petty 2000). Hence, annual reports are used

by firms to establish their desired position among their stakeholders, rather than to simply communicate the objective reality of the firm through IC disclosure.

Research methods

IC disclosure studies carried out in Australia (Guthrie and Petty 2000), Ireland (Brennan, 2001), Italy Bozzolan *et al.*, 2003), and Sri Lanka (Abeysekera and Guthrie, 2004, 2005) have all used annual reporting as their source document, with content analysis as their methodology for analysing the relevant information. Content analysis is defined as a technique for gathering data via the codification of qualitative information, in anecdotal and literary form, into categories in order to derive quantitative scales of varying levels of complexity (Abbott and Monsen, 1979, p. 504).

Guthrie, Petty, Yongvanich, and Ricceri (2004) point out that content analysis of annual reports has emerged as the most popular research method of IC disclosure studies in recent years. However, while these authors have been quick to commend content analysis for producing an objective, systematic and reliable analysis of data (Guthrie and Petty 2000), few have addressed the methodological problems associated with content analysis that can distort the findings of such analysis or, indeed, the credibility of its original textual source.

One major limitation associated with the content analysis method is the subjectivity involved in the coding process (Deegan and Rankin, 1996; Frost and Wilmshurst, 2000).

For instance, the method is heavily reliant on the integrity of the coder or researcher. There are several other limitations that are controllable by the researcher by careful planning of research. First, IC studies often tend to overlook the fact that results may differ depending on the scale applied for counting. The common scales applied for counting include the nominal, ordinal, interval and ratio scales. The purpose of the ordinal scale is to ascertain IC disclosure trends through frequency. The nominal scale establishes the median and interval of IC disclosure. The ratio and interval scales seek to quantify the distance between IC disclosure items (Carney, 1972, pp. 153-154). Table 1 vividly illustrates the effect different scales of measurement (frequency count and line count) being applied to the same source document using the content analysis method, leading to different results which may warrant different interpretations (Abeysekera and Guthrie, 2005).

[Table 1 somewhere here]

Based on a frequency count external capital has emerged as the most reported category whilst based on line count human capital is the most reported category.

Second, the composition of the sample in a given study can influence its findings. For instance, Guthrie and Petty (2000) in their study of Australia, and Abeysekera and Guthrie (2004, 2005) in their study of Sri Lanka, have controlled the size of firms included in their sample by selecting the top firms by market capitalisation listed on the Australian and Colombo stock exchange respectively. On the other hand, Bozzolan *et al.*

(2003) in Italy have chosen as their sample non-financial firms listed on the Italian stock exchange. Brennan (2001) in Ireland has examined knowledge-based listed firms on the Irish stock exchange. Brennan (2001) compares her results with Guthrie and Petty (2000), and Bozzolan *et al.* (2003) compare their results with Brennan and with Guthrie and Petty. However, while all these studies used a similar coding framework to analyse IC disclosure, their results were obviously different for a number of reasons, including the composition of the sample, making it difficult to accept the credibility of these comparisons.

Third, there are issues relating to the operationalising of content analysis. These include how to deal with sentences or paragraphs that give rise to more than one intellectual capital item or 'attribute'. One or more IC attribute can give rise to an IC category such as human capital, internal capital, and external capital. Additionally, there are issues related to how one would convert non-narrative information such as pictures, charts, tables, and numerical figures (both fiscal and non-fiscal) into a quantitative form to be analysed by content analysis. Thus operational definitions can give rise to differences in both results and interpretation.

It is possible that operational definitions of IC items in the coding framework, and the level of detail on which IC items were examined, may explain the substantial differences in IC disclosure between the top 20 Australian firms and top 30 Sri Lankan firms, which have been identified by the studies through frequency counts (Table 2).

[Table 2 somewhere here]

What is considered as IC disclosure can also have substantial influence on IC disclosure results and interpretation. For instance, Guthrie and Petty (2000) in Australia, Brennan (2001) in Ireland, and Abeysekera and Guthrie (2004, 2005) in Sri Lanka, have confined their analysis of the IC disclosure of annual reports to voluntary disclosure that is not mandated by accounting standards or corporations/company law. On the other hand, Bozzolan *et al.* (2003) do not clearly state whether they examined all disclosures or limited their analysis to voluntary disclosure. However, on the basis of the IC definition adopted in their study (i.e. all information perceived to be important by investors and analysts), it appears that they have examined both mandatory and voluntary disclosures, through a content analysis of annual reports.

Another method used, though to a limited extent, in IC disclosure studies is case study interviews. However, McKinnon (1988, pp. 36-52) points out that the validity and reliability of case study interviews can be compromised by five factors, all of which were applicable to this study. These factors are: observer-caused effects; interviewer-bias effects; data access limitations; complexities and limitations of the human mind; and low objectivity. These five factors will now be examined in more detail.

First, observer-caused effects can cause the respondent to change their behaviour in the interviews. Respondent may also have 'their own agendas' in answering the interview questions which may not represent factual affairs of the firm (Goddard and Powell,

1994). Second, interviewer-bias effects can affect the registering, interpreting and coding of the interview. Third, data access limitations refer to the fact that data gathering through the interview method is restricted to the period of that interview, limiting the quality and quantity of the data collected. Fourth, the complexities and limitations of the human mind mean that the statements made by the respondents cannot always be taken at their face value. This is because respondents can consciously seek to mislead or deceive the researcher about factual information related to the firm. However, even if respondents attempt to reply to the questions as honestly and accurately as possible, their statements can still be affected by natural human tendencies and weaknesses. Fifth, the interview method relies heavily on the integrity and intellectual honesty of the researcher, as the experience cannot be replicated due to the very nature of the method (McKinnon 1988, pp. 36-52). The above-mentioned factors can influence the quality of such results and their interpretation.

Statistical techniques as a research method are also used to a limited extent in IC disclosure literature (Bozzolan *et al.*, 2003) and this limited use of statistical techniques could be because several authors describe IC disclosure as an interplay between qualitative and quantitative information (Goh & Lim, 2004; Petty & Guthrie, 2000).

Most IC disclosure studies use only one research method. However, since every research method has its own strengths and limitations, it is recommended that research methods be combined so that, by complementing the weaknesses of each other, the validity and reliability of results can be improved. Such improvements in the methodological

approach used to analyse IC disclosure are necessary if the focus and agenda of the ICD project is to be strengthened.

4. ISSUES OF THEORETICAL INTERPRETATION

While Johanson, Martensson, and Skoog (2001) state that IC definitions are influenced by different theories of the firm, most studies into IC disclosure provide little or no theoretical basis for interpreting their findings. Some of the theoretical underpinnings could be used to understand and interpret findings regarding IC disclosure.

The resource-based view is a positivist perspective that supports market value maximisation using the capabilities and attributes of human capital (Becker, Husefield, Pickus and Spratt, 1997; Rogg, Schmidt, Shull, and Schmitt, 2001). Wernerfelt (1984) has pointed out that the resource-based view is built on the premise that a firm's success is largely determined by the resources it owns and controls. Resources are typically defined as either assets or capabilities. Assets, which may be tangible or intangible, are owned and controlled by the firm (Collis, 1994). Capabilities are intangible bundles of skills and accumulated knowledge exercised through organizational routines (Neslon and Winter, 1982). The usefulness of the resource-based view for such theoretical interpretation is empirically validated through evidence-based research (Galbraeth, 2005).

Bozzolan *et al.* (2003) propose signalling theory as a way of explaining why firms do not feel the necessity to signal the market with disclosure about their IC resources. They also

mention agency theory to explain why IC disclosure is not comprehensive. In essence, they argue that there are no incentives for managers to convince stakeholders of the optimal performance of their firm.

Guthrie *et al.* (2004) suggest two critical theories for use in studies of IC disclosure. The first theory, stakeholder theory, has an ethical branch, and a managerial branch. Using the ethical branch, it could be argued that stakeholders have a right to be treated fairly by a firm. Using the positivist (managerial) branch, it could be argued that the stakeholder's power, which is determined by the extent of that stakeholder's control over resources, influences the way management views that stakeholder. Therefore, naturally, the more powerful the stakeholder, the more likely a firm's managers are to take into account their expectations; hence influencing which information is communicated and how.

Second, legitimacy theory relies on the notion of 'social contract' between the firm and the society in which it operates. The social contract is used to represent the multitude of expectations that the society has regarding how a firm should conduct its operations (Deegan, 2000).

However, the corporate and social disclosure literature has pointed out that the notion of 'social contract' may fall short in explaining differential disclosure between countries. Adams, Hill, and Roberts, 1998 have found that there were significant differences in both the type and frequency of disclosures made by firms in different countries. While it was found that German and UK firms disclosed relatively large amounts of information, the

authors believed that the motivations behind their disclosures were different. The high level of disclosure by German firms was, they argued, due to employee involvement in the management of the firm, and was aimed at satisfying the unions as representatives of employees within the German corporatist system. The UK firms, on the other hand, disclosed more information to satisfy the needs of the trade union movement and the ever-expanding ethical investment movement. Other authors cite a different reason for the greater amount of disclosure by UK firms, arguing that firms are keen to improve their corporate image, and use annual reports as a means of advertising their firm and promoting its image (Gray and Roberts 1989, pp. 116-139; Adams *et al.* 1998).

An alternative, critical perspective on IC disclosure is provided by the political economy of accounting (PEA) perspective. The PEA perspective views accounting as a means of sustaining and legitimising the current social, economic, and political arrangements. In contrast to legitimacy theory, the PEA perspective argues that firms provide disclosure in a way that sets and shapes the agenda of debate, in order to mediate, suppress, mystify and transform the conflict between the firm and its social, economic, and political arrangements (Burchell, Club, Hopwood, Hughes and Nahapiet, 1980; Cooper, 1980; Cooper and Sherer, 1984; Tinker, 1980; Tinker and Neimark, 1987). It could be argued that practical shortcomings in management and individual managers to the demands of a socially divisive and ecologically destructive system within which managers work influence managers to provide disclosures in a way that sets and shapes the agenda of debate of the firm.

Abeysekera and Guthrie (2005) allude to the PEA perspective in their IC disclosure study of Sri Lanka. They state their results found contrast with the findings on social and environmental disclosure in other countries (Hughes, Anderson, and Golden, 2001). Hughes *et al.* have seen as user groups are seen to as exerting pressure for on firms to report environmental disclosure; in other words, where the voluntary disclosure (such as IC disclosure related) is seen as reactive rather than proactive (Guthrie and Parker, 1989). In contrast, Abeysekera and Guthrie (2005) argue that user groups do not exert any pressure on firms to disclose IC as they are not mandated by accounting standards, company law or other regulatory requirement. Rather, it is in the firm's own interest to report such information to stakeholders in order to enhance the perceived value of the firm.

The PEA perspective appears to provide a more suitable and germane way of analysing IC disclosure, as it introduces wider, systematic factors into the interpretation and explanation of IC disclosure phenomena, thus widening the researcher's focus of analysis and placing this research in its broader socio-economic and political context. This becomes even more important in the context of nations such as Sri Lanka, whose government retains a strong influence on business policy and in determining the level of competition, due to some large business enterprises being owned by the government (Corporate World, 1998; Hussein, 2000). These factors make the political, social and economic arrangements within which businesses operate even more important for their stability and continuity. As an illustration, some notable differences between Australia

and Sri Lanka in relation to political, social, and economic arrangements are shown in Table 3.

[Table 3 somewhere here]

As table 3 shows, the PEA perspective appears more robust compared to legitimacy theory with regard to inter-country comparative studies. This is because the PEA perspective takes into account the fact that differences in IC disclosure may arise not just due to social differences, but also due to political and economic differences. Much more can be done from this perspective in future ICD research.

5. CONCLUDING REMARKS

Recent research into IC disclosure practices have highlighted several issues that need to be resolved in order for IC disclosure research to be improved. This paper has sought to address some of these issues with a view to exploring possible solutions and future directions, and in doing so has reached some interesting observations.

Firstly, this paper highlights the lack of coherence between the value creation promoted by IC disclosure literature, and the various definitions of IC and IC disclosure. It has been argued that IC definitions have not adequately addressed the details of value creation, and that it is important to do so. In addition, uniform definitions of IC and IC disclosure are required, as this will allow for a more accurate comparison of 'reported' value creation between firms, thus improving the credibility of IC disclosure.

Secondly, it has been shown that the coding framework used to analyse annual reports needs to be critically analysed, and the real problems of comparability between IC disclosure studies addressed. In addition, operational issues arising from the use of the more popular content analysis research method in carrying out IC disclosure studies need to be resolved. It is suggested that combining more than one complementary research method can improve the relevance and reliability of results, and hence the future credibility of IC disclosure studies.

Third and finally, the theoretical underpinning of IC disclosure studies needs to be strengthened. While Positivist and critical theories can certainly contribute to this process, it is argued that inter-country studies would benefit from using the political economy of accounting perspective in order to initiate a much more critical examination of such results. This paper is but a critical beginning.

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Table 1

Overall results by intellectual capital category disclosure in Sri Lanka

	1998/1999 frequency	1999/2000 frequency	1998/1999 line count	1999/2000 line count
Internal capital	412	413	1684	1491
External capital	702	964	2984	3319
Human capital	596	790	3260	3200
Total	1710	2185	7928	8010
Number of firms in the sample	30	30	30	30

Table 2

Differences in results by intellectual capital category between
the Australian and Sri Lankan studies

	Sri Lanka	Sri Lanka	Australia
	1998/1999 frequency	1999/2000 frequency	1999 frequency
Internal capital	412	413	53
External capital	702	964	70
Human capital	596	790	53
Total	1710	2185	176
Number of firms in the sample	30	30	20

Table 3

Illustration of differences in political, social and economic arrangements
between two countries – Australia and Sri Lanka

Arrangement	Australia	Sri Lanka
Political	Labour legislation less in favour of workers	Labour legislation much in favour of workers
Social	Adult literacy rate of 100%	Literacy rate of 92%
Economic	Predominant growth in high technology, financial, and insurance firms; GDP per capita of US\$21,650	Predominant growth in trading and tourism firms; GDP per capita of US\$ 823

Source: AusStats: 6310 (2005); Guthrie and Petty 2000); <http://www.unicef.org/infocountry/Australia> [accessed 26 April 2005]; Central Bank of Sri Lanka Socio-Economic Data (2001, p. 2); McSheehy (2001, pp. 49-57)