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Keywords
intellectual capital, intellectual capital reporting, political economy of accounting

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POLITICAL ECONOMY OF ACCOUNTING IN INTELLECTUAL CAPITAL REPORTING

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Several factors shaping intellectual capital reporting (ICR) in the context of the political economy of accounting (PEA) theory were discussed in relation to traditional accounting reporting system, intellectual capital and intellectual reporting definitions, techniques employed to report intellectual capital (IC), and theoretical classification of IC. Reporting intellectual capital enables firms to report them in a fashion that best suits the relationship between the firm and their political, economic, and social arrangement. The unregulated reporting can increase manipulation of ICR in a borderless reporting environment to reduce the tension between the firm and its political, social, and economic arrangement.

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1. INTRODUCTION

The contemporary accounting can be described as a regulated institutional process and a constructed model to report and communicate the impact of economic activity (due to temporal and spatial displacements) and associated regimes of accumulation. It is an external reporting mechanism for profit oriented firms (Boczko, 1997, p. 13). The regulated process secures capitalist reproduction through institutional collection (such as laws and agreements), and norms and cultural habits. These institutional collections supports a capital accumulation regime by laws, state policy, political practice, rules of negotiation and bargaining, culture of consumption, and social expectations (Amin, 1994, p. 8). Tinker (1985, p. 84) argues that accounting is a belief-making informational commodity that measures and appraises the terms of exchange between different social constituencies, helps to allocate resources, and simultaneously determines a distribution of income. Accounting has become part of that exchange process by helping firms make decisions in relation to economic exchange. If the accounting practice did not take part in this way, competitive pressures would eradicate it as an unnecessary cost of production.

Tinker (1985, pp. 14-15) argues that share price do not reflect historical asset values but rather the earnings that those assets are expected to generate. Therefore, it is to the advantage of the managers to convince capital providers of that the management is capable of using those assets at the highest levels of efficiency through news releases which includes accounting reports such as company annual reports. In this context intellectual capital reporting (ICR)
presents two unique situations. First, unlike social and environment reporting, ICR is presently unregulated offering firms to make the choice of what to report, when to report and where to report. Second, ICR is proactive reporting since there is no need to meet any legislative or accounting requirements which enable firms to fictionalize ICR to maximise the market value of their firms to attract and retain capital providers.

This paper outlines the factors shaping ICR in the context of the political economy of accounting (PEA) theory. Section two of this paper reviews political economy and PEA and offer reasons why PEA is more applicable to ICR. The remaining sections outline the different variables and their impact on PEA: the role of traditional accounting; intellectual capital (IC) and ICR definitions; techniques for ICR; and, IC theoretical classification. The last section offers concluding remarks.

2. LITERATURE REVIEW

Firms are a focal point of economic, social, and political interactions in most market driven economies. They are places where the results of conflicts from the interactions leave their obvious marks (Grant, 1985 pp. 3-5). Therefore, it is necessary to comprehend the relationships between economic, social, and political forces to understand the changing characteristics of firms such as ICR in an unregulated reporting environment, and thereby the influence they have on the lives of different people.

The corporatism represents an attempt to understand such reciprocal relationships that have developed between the state and major organised interest groups. It is the process of negotiating policy between state agencies and interest firms that has arisen due to division of labour in the society. The policy agreements are implemented by collaborating with interest
firms (Grant, 1985: pp3-5). These interest firms should be willing and have the ability to secure the compliance of their members to deliver support of their benefiting constituency (Chubb, 1983:26). On that basis, the interest groups can be assumed to be big listed firms or the big listed industry groups. These arrangements are lead by both groups, which are state and interest firms, in seeking each other out (Schmitter, 1979:27). This is because corporatist arrangements are an unintended outcome of different conflicts and policy crises where neither state nor the interest groups were capable of imposing their preferred solution upon the others (Grant, 1985: 7).

The incapability to impose preferred solutions upon others arises because of four reasons. First, interest groups cannot attain the status of monopoly constituents, or form comprehensive hierarchies of sectors without some degree of official recognition or encouragement. Second, public officials should tacitly agree or actively promote interest groups to become regular, integral participants in making policies, or acquire direct responsibilities for policy implementation. Third, affected groups (interest groups or the government) may refuse to organise appropriately, or refuse to participate if they find the collaborating cost is too high. Fourth, relatively autonomous groups within the government form these arrangements. The government officials are much less enthusiastic to share the power of decision making with interest groups, but on the other hand, are not fully in control of the leadership selection of the interest group to bring about desired adjustments (Schmitter, 1985, pp. 35, 39).

For example, past research cites that unequal opportunity of employment (e.g. disabled, gender, and race) is a result of their poor social or political power to realise their economic wants as an interest group due to commodification of labour. This is because in a deregulated
economic approach, productive capital is privately owned and they hold the right to decide to make capital available for the preferred type of labour (Russell, 2002). Another research found that firms influence the nature of training and wage structure, and in a competitive labour market firms have little incentive to invest in general skills of employees since they can take those skills to other firms (Acemoglu & Pischke, 1999).

However, past case studies indicate several ways to enhance the capability of imposing a preferred solution by an interest group. First, is to express all demands through only a few voices for negotiation and compromise. Second, is to centralise the internal structure of the interest group to increase consensus formation and member compliance. Third, is to modernise the interest group to increase its professionalism. Fourth, is to create ‘modern’ interest groups to play their role in corporatist co-operation (Marin, 1985,:pp. 97-100). Fifth, to have less distinction between private and public corporatists or forge partnerships between private and public interest groups in delivery of products and services (King, 1985, p. 205).

Most of the discussion on corporatism is based on tripartite bargaining between capital (economic), labour (social), and government (political) at a national level. However, understanding the corporatist phenomena at below the national level enhances comprehension of how corporatism can flourish in particular sectors or locations even when it is not apparent at the national level of a nation. The cumulative impact of such arrangements on the society could be as important as weakly enforced tripartite arrangements of a nation (Grant, 1985, p. 4).
When attempting to enhance a socially optimum level or type of reporting of IC, it should examine the corporatist phenomena both at corporate sector level and at national level while enhancing the preferred by an interest group such as the state.

The central importance of political economy theory is to promote the process of adjustment through the political capacity of the government (political), and is often pursued by working together with their economic (capital) and social (labour) representatives (constituents) (Zysman, 1983, p. 15).

The PEA theory views that accounting is a means of sustaining and legitimising the current social, economic, and political arrangements. Accounting information is used to support those groups who are currently powerful in the society (Cooper, 1980; Cooper & Sherer, 1984). Accounting reports are a means to construct, sustain, and legitimise the economic and political arrangements in the private interests of the firm (Guthrie & Parker, 1990). It takes the view that there are two opposing forces or principles that create tension in relations with the constituents in the arrangement (Buhr, 1998). Firms proactively provide information from their perspective to set and shape the agenda of debate, and to mediate, suppress, mystify and transform the conflict (Guthrie & Parker, 1990).

Based on the above characteristics, the PEA theory is relevant to ICR for the following seven reasons. First, adopting the PEA theory perspective to ICR can widen the researcher’s focus of analysis, by explicitly attempting to introduce wider, systematic factors into the interpretation and explanation of ICR phenomena (Gray, Owens, & Adams, 1996, p. 47). These factors make the political, social and economic arrangement in which a business operates more important for its stability and continuity. Second, ICR is about proactive
reporting. They are not reported to meet any regulatory requirements. The PEA theory focuses on proactive corporate disclosure provided from the management’s perspective. It is designed to set and shape the agenda according to its own self-interest (Burchell, Club, Hopwood, Hughes & Nahapiet, 1980; Cooper, 1980; Cooper & Sherer, 1984; Tinker, 1980; Tinker & Neimark, 1987; Woodward, Edwards & Birkin, 2001). Third, the political economy perspective perceives accounting reports are social, political, and economic documents. They are been used as tools to construct, sustain, and legitimise economic and political arrangements, institutions, and ideological themes, which contribute to the firm’s private interests (Guthrie & Parker, 1990). Firms use annual reports as a tool to ease tension in social relations between the firm and the society, and stay away from any regulation. It can possibly use different reporting units to varying degrees and can use different reporting locations within the annual report for such purposes. This is because political economy perspective critically focuses on themes, meanings, and motivations implicit in voluntary disclosures. Annual reports may not reflect the true position of the firm as empirical findings indicate that there was no systematic relationship between the quantity of disclosure in annual reports and IC performance (Williams, 2001). This is because most listed firms use the annual report as a promotional or marketing document rather than merely to comply with accounting standards and the law (Abeysekera, 2002a). Fourth, the political economy approach takes the view that there are two opposing forces or principles that create tension in social relations (Buhr, 1998). In the area of corporate reporting, such tension can manifest due to the size of the firm, industry sector, ownership structure (such as diversity of share ownership or/and number of shareholders), ownership type (such as foreign or local), and difference between the market value and the net book value of the firm. Firms in return can use more disclosure in IC to ease such tensions. Fifth, specific previous researches on ICR (Brennan, 2001; Guthrie & Petty, 2000) have shown that the frequency of IC reported
voluntarily by large firms varies in annual reports. These specific studies also demonstrated that IC items reported in annual reports could differ from country to country (Brennan, 2001; Guthrie & Petty, 2000; Olsson, 2001). The differences in reporting can be due to firms reporting to create harmony in social relations between the firm and its social, political, and economic framework. Sixth, the knowledge economy facilitates propagation of thoughts, value, and power, by ultimately packaging and selling them in language. Past research on both IC and corporate social reporting confirmed that firms have used various reporting units both qualitative (i.e. charts, tables, photographs and narrative) and quantitative (i.e. non-fiscal and fiscal) in varying combination. However, several authors have pointed out that narrative is the predominant mode used in reporting of corporate social reporting and IC reporting (Andrew et al., 1989; Collier, 2001; Brennan, 2001). The choice of reporting units can determine to what extent the relations are maintained with their relevant constituents because narrative is a powerful way to make sense. Seventh, the reporting location within the annual report can have an impact on social relations between the firm and its social, political, and economic arrangement (Choon, Smith & Taylor, 2000; Hughes, Anderson & Golden, 2001). Although why a particular reporting location is preferred has not been completely resolved by a theory in the past, PEA theory can provide helpful guidance.

3. ICR IN THE CONTEXT OF PEA

Several factors contribute to shaping ICR in a PEA context as outlined in Figure 1 and discussed in the following sections.

*Role of traditional accounting*

The empirical studies cite several limitations imposed by the traditional accounting system in ICR. First, is the writing off of intellectual assets as expenses (Backhuijs, Holterman,
Authors have demonstrated that it leads to systematic under-valuation and relatively adverse liquidity of firms (Boone & Raman, 2001a; Boone & Raman, 2001b; Ronen, 2001). Dunk and Kilgore (2001) in a questionnaire response combined with telephone interviews of finance directors in Australia indicated that firms are likely to cut R&D expenditure to focus on short-term financial performance when the emphasis in the marketplace is on cost more than on product innovation. The literature suggests two ways to overcome the deficiency: (i) Hoegh-Krohn and Knivsfla (2000) suggest that to overcome the anomaly within the traditional accounting system is to reverse the previously written off intangibles once they meet the recognition criteria of an asset; (ii) Thompson (1998) suggests firms can add a supplementary set of reporting elements to acknowledge forms of capital and claims to capital that cannot be measured in financial terms. Others agree that it is more useful to measure them even if they are less exact with new rules of measurement (Heckmian & Jones, 1967).

Several authors hold the view that using accounting figures without IC (like knowledge) in financial statements is a concern when seeking solutions to management problems (Dearden, 1960; Anthony, 1965; Moorhow, 1990; Buhner, 1997; Davies & Waddington, 1999; Petty & Guthrie, 1999; Rohwer, 1999; Copeland, 2000; Allen, 2001). This has resulted in the current reporting system not presenting objective reality (Wharton Alumni Magazine, 1997) and it has not been a meaningful indicator of economic efficiency of a firm (Hansson, 1997; Graham & King, 2000; Zambon & Zan, 2000). This view is supported by others who argue that the present balance sheet records what has been spent and is silent on value addition to the firm (Swinson, 1998 pp. 4-5; Horney, 1999) and measures only the realisation of value rather than the creation of value of a firm (Romer, 1998; Brennan, 2001).
Second, accounting standards in most countries permit only recognition of purchase goodwill to be reported in their financial statements, which represents only a portion of IC (van der Meer-Kooistra & Zijlstra, 2001). On the extreme end are Austria and Germany that do not recognise any intangible assets (Bornemann, Knapp, Schneider & Sixl, 1999). Japan recently amended their accounting regulation to record purchase goodwill in the consolidated accounts only (Okano, Okada & Mori, 1999). According to Unwin (1990) the outcome available for several countries is to amortise purchased goodwill. The literature also suggests that the lack of national homogeneity in accounting standards on intangibles may have given rise to a lack of international homogeneity on accounting standards on intangibles (Stolowy & Jenny-Cazavan, 2001). The International Accounting Standards (IAS) 38 which specifically prohibit recognition of startup costs, training costs, and advertising costs, could be cited as an example. They also prohibit recognising internally generated goodwill (IAS38 1998, pp. 983-1031) and have failed to respond well to current market needs of reporting IC (Ravlic, 2000).

[Figure 1 should appear somewhere here].

Third, some suggest that accounting theorists compound the weaknesses in traditional accounting by presenting theories that have little relationship to actual economic conditions (Merino, 1993). They have adopted a less pragmatic perspective by viewing it as a purely technical discipline, and have failed to analyse the role accounting plays in the society. Chapman (1997) states that the failure to respond to the contingent nature of accounting lead to the loss of credibility in the accounting profession (Chapman, 1997). Further, the coexistence of several accounting approaches also has made it complex to verify the multi-dimensional character of ICR in a firm (Zambon & Zan, 2000).
The above-mentioned weaknesses of traditional accounting are believed to be responsible for the gap between the market value and the net book value of the firm. The gap has highlighted and questioned the relevance of accounting numbers reported to make economic decisions (Power, 2001; Tollington, 2001). However, it has become evident that the accounting profession in some countries such as is heading towards measuring and reporting assets in reference to the market value (Lashinsky, 1999) as shown by their recently published accounting standards (ASCPA, 1999, pp. 6677-6782).

The technology has enabled businesses to change their approach in reporting information to meet market needs of users (Jenkins, 1998, p. 1; Swinson, 1998; p. 4; ICA E&W, 1998, pp. 2-3). Therefore, authors predict that the annual report of the future would recognise forward-looking information such as IC (Roos et al, 1997, p. 21; Benjamin 1998, pp. 13-15). However, the profession is actively debating the issue of how to measure, manage, and report IC. Several authors agree that it is yet to gather a critical mass to achieve a significant change in the accounting profession (Benjamin, 1998, pp. 26-27; Brennan, 2001; Cook, 1998, p. 29; Fay, 1998, p. 28; Lipworth, 1998, p. 26). It is unlikely to see any major changes in the accounting standards followed by accountants mandated by the accounting profession to recognise IC in financial statements in the near future (Brennan, 2001). Several techniques have been developed to overcome the deficiency in ICR.

The limitations imposed by the traditional accounting system in ICR, the theories which have little relationship to actual economic conditions, and the decided reluctance of the accounting profession to recognise IC in financial statements have encouraged firms to report IC in an ad-hoc fashion. These factors indicate that IC reporting will perpetuate for some time in an
unregulated reporting environment allowing firms to manipulate the economic, social, and political arrangement through unregulated ICR.

**Definitions of IC and ICR**

Edvinsson and Sullivan (1996) and Petrash (1996) outline intellectual assets as synonymous to IC. Many of them take a strategic view but they vary in their meanings from each other (Edvinsson & Sullivan, 1996; Brooking, 1997; Edvinsson, 1997; Edvinsson & Malone, 1998; Stewart, 1997, p. X; Klein, 1998, p. 1; Nasseri, 1998; Saint-Onge, 1998; Ulrich, 1998; CMA, 1998, p. 3; ASCPA & CMA, 1999, p. 4; Knight, 1999). The Society of Management Accountants of Canada (SMAC), on the other hand, offers an accounting based definition (IFAC, 1998, p. 12). However, the 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 owning the asset and others define using the criterion of controlling the asset (CPA Australia, 2000, pp. 49-69; IAS38, 1998). The diversity of definitions shows there is difficulty arriving at uniformity of definitions (ASCPA & CMA, 1999, p. 53) and a generally accepted theory of IC (Canibano, Garcia-Ayuso, Sanchez & Olea, 1999; Petty & Guthrie, 2000; van der Meer-Kooistra & Zijlstra, 2001).

ICR has not been defined in the literature. However, the Australian accounting handbook 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. 0005). Using the definition of general purpose financial reporting as a basis, this thesis defined ICR 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 & Guthrie, 2002). In doing so, the benefits should justify the cost incurred in reporting them. The availability of several definitions and a lack of an uniformed definition of IC and IC reporting, enable firms to define them in an ad-hoc fashion for reporting purposes. The ad-hoc definitions can become the basis for justification of unregulated ICR which firms can manipulate to orchestrate their political, social, and economic arrangements.

*Techniques for reporting ICR*

Several techniques have been proposed to measure ICR as ratios and values (Montague Institute Review, 1998). The techniques could be classified into two broader categories, those that measure and report them at firm (macro) level for inter-firm comparisons and others that measure and report within firm level (micro) for inter-divisional comparisons (Abeysekera & Guthrie, 2002).

Six broad indicators are used for measuring and reporting IC between firms: (i) the market to net book value; (ii) Tobin’s q ratio; (iii) calculated intangible value; (iv) direct IC; (v) Baruch Lev’s knowledge capital valuation; and (vi) Paul Strassmann’s knowledge capital valuation. Market to net book value (Roos, Dragonetti, & Edvinsson 1997, p. 2; Sveiby, 1997, pp. 3-18; Knight, 1999; Brennan, 2001) is the most popular and widely known indicator (Knight, 1999).

There are three ways to construct indicators to report IC within firms (Roos & Roos, 1997). These are, indicators as drivers of the vision, indicators to represent intellectual categories and indicators to represent inter-capital flows. The IC index is an indicator developed as a
driver of the vision of a firm (Roos & Roos, 1997). The Intangible Assets Monitor™ is a model developed to report IC as an indicator in relation to growth and renewal, efficiency, and stability of a firm (Sveiby, 1997, pp. 163-184). The Intellectual Accounting Scorecard is another model that integrates ICR into mainstream traditional accounting reporting (Abeysekera, 2002b). The return on knowledge assets on IC items is another reporting approach (Dekker & de Hoog, 2000) constructed to report indicators to represent inter-capital flows.

As outlined in this section, IC performance can be measured and reported in six different ways for inter-firm comparison, enabling firms to adopt the reporting measure that fits best in their favour. The IC performance within the firm can also be reported in three broad methods, offering the firm a wider choice to select an appropriate indicator. The wide choice of ICR indicators to report performance both within and between firms enables firms to manipulate their political, social, and economic arrangements in an unregulated environment.

**ICR via theoretical classifications**

The theoretical classification of IC is simple and several, but Canibano et al. (1999) argue that they are not exhaustive. The analysis of IC available in the literature can be classified into five major frameworks: (i) Structures holding intellectual assets (Sveiby, 1997, pp. 93, 11-12, 165). This framework focuses on intellectual assets; (ii) Capital holding intellectual items (Edvinsson, 1997; Edvinsson & Malone, 1998; Roos et al., 1997; Edvinsson & Sullivan, 1996), which has been modified by others (Stewart, 1997, pp. 229-246; Roos & Roos, 1997). It discusses ICR in relation to intellectual assets; (iii) Assets representing IC (Brooking, 1996, pp. 13-15, 129; 1999, pp. 153-155) but it focuses on intellectual assets; (iv) Strategic root and measurement root (Roos et al., 1997, p. 15) and it focus on the role of IC;
(v) A combination of assets and capital representing IC (SMAC, 1998, p. 14; IFAC, 1998, p. 7). This framework is an extension of the assets representing IC. The organisational (structural) capital represents intellectual property and infrastructure assets.

As outlined in this section, five major theoretical frameworks are discussed in the literature offering a choice of frameworks to report IC.

3. CONCLUDING REMARKS

The inconsistent measurement rules to recognise accounting elements and the decided reluctance of the accounting profession to recognise IC in financial statements, and non-uniformity of treatment of accounting elements between countries, has enabled firms to report IC in an unregulated environment. Accounting theorists proposing theories that have little relationship to economic conditions also has confounded the reporting aspects of IC. The literature offers several strategic and one accounting-based definition on IC. There was also hardly any definition of ICR in the literature. The absence of a uniform definition of IC and ICR has widened the reporting definitions and thereby increased ICR choices of firms. A literature review also identified four methods of ICR. First, reporting as ratios, at both inter-firm and intra-firm level. Second, reporting as indicators to represent the vision of the firm, IC categories, and return on IC items. Third, reporting via IC statements. Fourth, reporting via IC framework. These choices offer firms the ability to select the best way to report IC in their favour. These choices of non-uniform ICR enable firms to use IC as a commodity to mediate their political, economic, and social arrangements. Although regulating ICR may not eliminate firms using IC as a commodity, unregulated reporting can enable firms to manipulate ICR to reduce tension between those firms and political, economic, and social structures, in a boundary-less environment.
Figure 1

ICR in a PEA context

- Vacuum in the traditional accounting system
- Non-uniform definitions of IC & ICR
- ICR in a PEA context
- Wide choice of techniques for ICR
- Wide range of theoretical classification of IC
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