Chapter XI

Intellectual Capital Reporting: Can a Strategy Perspective Solve Accounting Problems?

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ABSTRACT

During the last decade, many calls for improving disclosure practices, in relation to intellectual capital and intangibles, have been uttered in the standard setting, academic, and business communities. There seem to be two types of solutions to this problem. One angle of attack is to seek to improve transparency through implementation of global accounting standards, and moving from historic value to fair-value practices. Another way of dealing with the problem is to step outside the accounting paradigm to see if transparency and relevance problems can be solved by way of supplementary disclosures. For some, this is a logical step. However, for many, this represents shaky ground. It is ironic that while supplementary information has been shown to reduce investors’ uncertainty, it is not being acknowledged as a key element in solving the existing problems by standard setters and academics. This chapter is a wake-up call to the drowsy constituents of academia and policy making, asking them to see beyond their normative accounting paradigm and in turn, showing them how far the strategy-oriented solutions they choose to ignore have come. In this chapter, we thus illustrate for the reader how reporting and management of companies’ knowledge resources and intellectual capital is possible through the strategic ideas of the Danish guideline for IC statements.
INTRODUCTION

There has been a lot of discussion in recent years of whether or not both accounting standards and firms’ reporting of their assets of intellectual capital to the business environment are sufficient. This discussion is often coupled with the emergence of the knowledge society and the so-called “new economy,” where intellectual capital, rather than physical capital, has become the pivotal factor underlying value creation. These changes, associated with the developments in the business environment, such as globalisation and faster innovation rates, have also altered the demands for organizational communication, because traditional financial reporting seemingly is unable to meet the information requirements of users. Hence, it is argued that the prerequisites for transparency have changed.

As such, this chapter promotes a link between the ongoing developments in global business and the necessity of managing intellectual capital; a link that can be attained through the strategic focus of the Danish guideline for intellectual capital reporting. Hence, the notion put forth here is that “accounting” for intellectual capital is a strategic management issue rather than an accounting-based measurement issue.

It is widely accepted that intellectual capital, strategy, and other drivers of value creation constitute strategically important elements for the future profitability and survival of companies. Many firms already disclose much supplementary information in their management commentary regarding strategy, market competition, technological developments, and products in the pipeline. Also, in the Nordic countries and, more recently, in a number of other European countries, companies have been experimenting with disclosing such voluntary and forward-looking disclosures through intellectual capital statements.

The problem, as well as the prospect, with strategy, is that it is about being different. Hence, the bundle of indicators on strategy, intellectual capital, and so forth, that will be relevant to disclose, will differ among firms. For such information to make any sense at all, it should be inserted in the particular firms’ strategic context, thereby determining their relevance in relation to the company’s value-creation process. In other words, it does not make sense to insert such information into a standardized accounting regime.

Therefore, further elaborations will need to move on from the accounting agenda, and at the least, recognize that these differing perspectives exist. It can be argued that the accounting agenda initially spurred the interest in supplementary business reporting (cf. American Institute of Certified Public Accountants [AICPA], 1994), but that the debate, in recent years, has moved on, and is now more preoccupied with visualizing strategy and the business model rather than measuring for example companies’ intangible assets in monetary terms. There have been a number of attempts at constructing business reporting models inherently concerned with strategy, and about showing future-oriented perspectives on the company, which accounting cannot.

Business reporting is the generic term used to identify the type of reporting that the accountancy profession has come to recognise as, if not a direct successor to its highly successful corporate reporting approach, then at least a complement. Because of this, like corporate reporting, business reporting is, at base, a further manifestation of financial reporting, the practice upon which a major part of the reputation of the accountancy profession is based. Assuming that the accountancy profession, one well known for its collective conservatism, is unlikely to willingly reconstitute itself in a radically different guise, it is reasonable to expect that a business-reporting approach is unlikely to depart significantly from the predecessor corporate-reporting approach.

A key motivation for rethinking the latter approach to financial reporting was the recognition that the principal users (Jenkins’ “customers”) of such reports, investors and analysts, were no
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