

A Conceptual Paper on Intellectual Capital Disclosure Practices

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Introduction

At present, the world economy is transiting from an industrial economy to a Knowledge Based Economy (KBE) in order to enhance the wealth creation (Abhayawansa 2013). As per this transition, to be sustaining the competitive advantage, the economy has to depend on the knowledge based capital so called the Intellectual Capital (IC), such as: knowledge workers, employee related measurements, patents, trademarks, organizational systems and business strategies (Rashid 2010).

As far as stakeholders of the companies are concerned, the annual report is one of the primary methods used to communicate the companies' response to stakeholder concerns. It is the right of all stakeholders to obtain all the information of the company, including IC information. Sri Lanka Accounting Standard for intangible assets - LKAS 38 sets out the accounting treatment, recognition and measurement of intangible assets of the companies' financial statements. As per this Standard, the term intangible assets are defined as identifiable non-monetary asset that is not physical in nature and owned to be used in generating or handling over goods and services. Intangible assets are very difficult to be recognized in companies' statement of financial position under the current accounting and reporting framework. Therefore, companies tend to report these resources voluntarily in their annual reports (or on websites) (Yi & Davey 2010). As far as IC is concerned, the disclosures of IC are generally related to those in the guidelines of G3.1 or G4 as per Global Reporting Initiative (GRI) (Senaratne, Ajward & Liyanapathirana 2015). These guidelines are generally considered as representing current best practice reporting on sustainability.

Problem Identification

In Sri Lanka, companies are investing huge amounts in training its employees. These heavy investments to train and retrain quality staff are not reflected in the statement of financial position of these companies in various industries. This is also due to strict recognition criteria for IAs that do not allow human capital to be shown as an asset in the statement of

financial position (Abeysekera & Guthrie 2005, Agne & Maria 2014, Abhayawansa & Guthrie 2014). Jayasooriya, Gunawardana and Weerakoon Banda (2015) state that

‘[t]he different practices of disclosing the IC in annual reports do not result the real financial position of the firm, is a key problem in Sri Lankan business organizations’.

In order to address the problem identification, the following research question need to be answered. What are the ways in which public listed companies disclose IC information in annual reports? Based on the literature review, this paper sets out to achieve the following objectives: to examine the nature of disclosing the IC information based on the content analysis of annual reports and to reveal the major findings of past Sri Lankan ICD research studies. This research contributes to limited research in the context of Sri Lanka since past research repeatedly concerning on developed economies. The remainder of this paper is structured as follows. First, literature on ICD is reviewed. Next, research methods are detailed. Following section discussed the findings of the study. Finally, conclusions are given.

Review of Literature

Having reviewed the literature on prior studies from 2004 to date in Sri Lanka, this section identifies the research gaps. Abeysekera and Guthrie (2005) found that there was no consistent theoretical framework of reporting intangibles in Sri Lanka. From the panel data only the extent of ICD over the period can be identified. Most of the prior studies considered the single year and some other studies considered less than three-year period. Table 1 details the longitudinal ICD studies conducted in Sri Lanka.

Methodology

IC information in terms of internal capital disclosure, external capital disclosure and human capital disclosure were adopted as an instrument to examine the nature of ICD information by Sri Lankan listed companies. This conceptual paper is employed the content analysis of the annual reports as a qualitative research method. Companies with higher market capitalization are most likely to disclose IC information from 2011 onwards incorporating G3.1 guidelines. For an instance Union Assurance PLC has been preparing its annual reports in accordance with Integrated Reporting (IR) and GRI guidelines since 2011. Three years’ annual reports from 2013 to 2015 of the top 30 companies in terms of highest market capitalization as of 10th of June 2015 were screened in terms of words, sentences, pictures, tables and graphs. For the purpose of this conceptual paper, a list of ICD items has been developed by Malawara Arachchi and Kehelwalatenna in 2011 was modified by the authors and used in this study.

Table 1: Longitudinal ICD Studies Conducted in Sri Lanka

Authors	Sample	Annual reports	Method	Major findings	Statistical analysis
Abeysekera and Guthrie (2005)	30 companies	1998/1999	Content analysis	Most reported external capital frequency and human capital by line count.	Not specified
Abeysekera (2007)	30 companies	1998/1999 and 1999/2000	Content analysis	Difference ICR practices Sri Lanka and Australia due to the differences in economic, social and political factors.	Correlations and regression
Abeysekera (2011b)	90 companies	1998-2000-2002-2004	Content analysis	Does not include narrative, visual, or numerical ICD and narrative disclosure, but not visual or numerical ICD.	Correlations and regression
Malawara Arachchi and Kehelwatenna (2011)	5 banks	2006 - 2009	Content analysis	ICD revealed that there was increasing trend of the disclosure of the higher level human capital and external capital.	Not specified
Abeysekera (2014)	30 companies	2001-2002	Content analysis	Signals differ between industry sectors in convincing stakeholders to advance external capital accumulation	Correlations and regression
Jayasooriya, Gunawardana and Weerakoon Banda (2015)	90 companies	2011-2013	Content analysis	25% of companies reported HCD. 13% of companies reported organizational capital. 15% of companies reported social capital.	Frequency analysis

Source: Researcher constructed based on the literature review.

This list was classified under category of internal capital disclosure, external capital disclosure and human capital disclosure to analyze the nature of ICD through content analysis of the annual reports of companies.

Findings from Sri Lankan listed companies' annual reports based on content analysis

Most of the companies are preparing their annual reports in the following headings, such as: group highlights, governance, sustainability integration and risk management, management discussion and analysis, financial statements and supplementary information. These sections generally cover the IC related information in terms of quantitative and qualitative as well. For instances: Sampath Bank PLC disclosed employee related measurements as:

'Profit per employee LKR 1.2 million, employee retention 97% in 2014' (Sampath Bank PLC 2014, p. 34).

Dialog Axiata PLC 2014 disclosed employee welfare as:

'The BOD of the bank at its meeting held on February 23, 2015 approved a proposal to introduce an ESOP for the benefit of all Executive Officers in grade 1 A and above by creating up to 2% of the ordinary voting shares at the rates specified in the proposed ESOP in 2016, 2017, 2018, upon the bank achieving specified performance target set for the years 2015, 2016 and 2017 respectively in the proposed ESOP. P.405 88,649,900 options were granted in June 2005 under Tranche 0 to eligible employees at Rs.12 each. Up to 25 October 2014, out of the total number of share options granted under Tranche 0, a total of 51,330,499 options had been exercised and a total of 11,562,301 options had been forfeited. 226,800 options were exercised by the employees during the financial year' (Dialog Axiata PLC 2014, p. 110).

Union Assurance PLC disclosed training and development as:

'Investment in training and development LKR million 49' (Union Assurance PLC, 2014, p. 9).

Most of the companies were qualitatively disclosed the items of internal, external and human capitals in their annual reports. As compared from 2013 to 2015, there was generally an upward trend of the disclosure of IC items of the sample companies.

Conclusion

In this conceptual paper, the authors conducted a comprehensive literature review with respect to ICD specially in Sri Lanka. The findings show that there was a generally increasing trend of ICD in the Sri Lankan listed companies. Most of the Sri Lankan listed companies are now being disclosed the IC information in their annual reports in terms of words, sentences, pictures, tables and graphs with the core discipline of GRI4 guidelines.

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