



Reporting intangible assets: Voluntary disclosure practices of top emerging market companies

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Abstract

This study is the first to empirically examine the applicability of the Value Chain Scoreboard™ proposed by Lev (2001) as an alternative disclosure framework for intangible assets (IA). The context of the research is the top 200 emerging market companies, which are the focus of increasing international attention. We empirically examine the extent of IA disclosures and find that emerging market companies do actively engage in voluntary disclosure practices to disseminate mainly quantitative IA information to their global stakeholders. Corporate-specific factors such as the adoption of IFRS/U.S. GAAP, industry type, and price-to-book ratio are key influences significantly associated with the level of IA voluntary disclosure. In addition, country-specific factors, including risks associated with economic policies and legal systems, are found to be significantly associated with the level of IA disclosure.

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1. Introduction

While there is an increasing awareness of investment opportunities in emerging economies,¹ these markets generally are not considered to possess and/or maintain high-quality and transparent financial reporting frameworks. Emerging market companies, therefore, engage in voluntary disclosure practices in order to compete for funds on equal terms

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¹ An emerging market is an economy that satisfies two criteria: (1) a rapid pace of economic development and (2) one where the government policies favor economic liberalization and the adoption of a free-market system (Hoskisson, Eden, Lau, & Wright, 2000).

with other corporations originating from developed economies in international markets (Wang and Claiborne, 2008; Purushothaman et al., 2000; Meek et al., 1995). Voluntary disclosures are additional disclosures, primarily outside the financial statements, that are not explicitly required by GAAP or any accounting standards (Wang and Claiborne, 2008; Boesso, 2002). Disclosure studies assume that managers have superior information to outside investors on their firms' expected future performance; therefore, voluntary disclosures are associated with lower agency costs, reductions in the cost of capital, and improvements in the market price of securities (Leuz and Verrecchia, 2000; Botosan, 1997).

The focus of our study is on one particular type of disclosure that has become popular in recent years; the disclosure of information about intangible assets (IA). An intangible asset is a claim to future benefits that does not have a physical (e.g., building or equipment) or financial (e.g., stock or bond) embodiment (Lev, 2001).² For example, patents, brand names, and unique organizational infrastructures that generate cost savings for companies can be defined as IA. The relatively recent growth of the service sector and of information technology-related businesses, along with the dramatic increase in the number and size of international mergers and acquisitions, has made accounting for IA very significant (Lev, 2001; Saudagaran, 2001).

Currently, there are few comprehensive guidelines for corporations in either International Financial Reporting Standards (IFRS) or in U.S. GAAP on how to report IA, other than for purchased goodwill and some development costs, in company financial statements.³ That is, while the importance and the necessity of such assets in creating and maintaining corporate value have been widely accepted, traditional financial reporting frameworks unfortunately do not capture many of these value drivers (Jenkins and Upton, 2001; Upton, 2001; Lev and Zarowin, 1999) due to the "non-physical" nature of IA and the subsequent uncertainties associated with their "future benefits." It may be naïve to assert that total transparency regarding IA would automatically enhance the quality of corporate information being distributed to external stakeholders; however, given the increasing importance of IA in driving corporate value, it can be argued that corporations should nonetheless voluntarily communicate relevant and useful information on IA to their stakeholders. While the concept of IA management and reporting practices in developed economies has been examined in the previous literature, the status of IA voluntary disclosure practices, and corporate and country specific factors behind such practices, in the emerging economies has not. In this study, we examine the voluntary disclosure practices of the top 200 emerging market companies in respect of information about IA. Specifically, we develop a disclosure index based on the Value Chain Scoreboard™ (Lev, 2001) to investigate both its applicability, which has not been assessed empirically, and the extent of IA voluntary disclosure practices. We also evaluate some of the likely factors that may influence the level of IA disclosure.

² It has been argued that "the terms *intangibles*, *knowledge assets*, and *intellectual capital* can be used interchangeably and they all refer essentially to the same thing" (Lev, 2001; p. 5). Mouritsen (2003; p. 18) claims that intellectual capital "is presented as the intangible stuff, out of which value in a knowledge society and therefore knowledge organisations are created". Sveiby (1997) views intangible assets as a combination of "knowledge-based assets." For the purpose of the current study, we adopt Lev's views.

³ For definition and recognition criteria, see AASB 138 [AASB, 2004], SFAS 142 [FASB, 2001], and IAS 38 [IASB, 2004]. Most IA would fail the recognition criteria set out in these standards.

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