

DISCRETIONARY DISCLOSURES OF INTANGIBLE ASSETS: MALAYSIAN EVIDENCE

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ABSTRACT

Discretionary disclosure is a channel frequently used by companies to communicate their intangible assets to their stakeholders. This paper examines the extent of discretionary disclosures of intangible assets of 100 randomly chosen Malaysian listed companies. The disclosures are analysed based on their locations (non-financial statements sections)and the association between the discretionary disclosures of intangible assets and noncapitalised intangible assets (measured in terms of market to book ratio).Out of the 12 intangible attributes under review, it is found that 'product' attribute is the highest disclosure, implying that products are the most frequently promoted. It is also found that the higher the noncapitalised intangible assets the greater the discretionary disclosure of intangible assets. Chairman's statement appear to be the most popular vehicle used to communicate their intangible assets. As reporting of intangibles is discretionary, Malaysian companies may communicate their intangibles in the management commentary as a step forward in supporting 'narrative reporting' as recommended by the International Accounting Standards Board.

Keywords: *discretionary disclosure, intangible assets, non-capitalised intangible assets, intellectual capital, Malaysia*

Introduction

The current landscape of corporate reports has witnessed an increasing usage of discretionary disclosures to communicate business stories to their stakeholders (Beattie, Dhanani and Jones, 2008; Hossain and Hammami, 2009). This increase, according to Al Razeen and Karbhari (2004) is a response to the limitations of mandatory disclosures. Companies use discretionary or more often known as voluntary disclosure as an alternative means to communicate their business affairs and activities. This practice is employed by many companies to report their intangibles or intellectual capital as current mandatory disclosure of intangible assets in the annual reports is rather limited.

The shift of business focus from the tangible assets to the intangible assets has posed doubt on the decision relevance of information produced under the conventional financial reporting system (Abeysekera, 2008). According to Gerpott, Thomas and Hoffman (2008, p. 37), the 'economic relevance of intangibles has hardly been reflected in the mandatory rules required by the international reporting standard setter'. This is mainly because most intangibles or intellectual capital fall outside the traditional recognition criteria for assets. As a result, business intangibles are not fully captured in the financial statements. Hence, companies have to turn to other approaches to make known their intangibles which are recognised as value drivers in today's economy.

In addition, according to Davison and Skeratt (2007), portraying intangibles discretionarily in the annual reports is a better way of communicating as compared to the use of accounting numbers alone. Discretionary disclosure of intangibles also serves as a supplement to reported earnings by increasing the value relevance of financial statements (Depoers, 2000). The growing importance of discretionary disclosures as a supplement to the statutory accounting information calls for a closer scrutiny on the extent and content of such disclosures.

Since 2004, the Malaysian market has begun developing its intangibles though at a slower pace (Salamudin et al., 2010). As such, Malaysian companies could have used discretionary disclosures to report their intangibles even though such reports are not required by the existing

financial reporting standards. The main aim of this paper is to explore the discretionary disclosures of intangible assets in the annual reports of Malaysian public listed companies. It examines the extent of discretionary intangible asset disclosures in terms of occurrences in various reports or statements in the annual reports. This paper also analyses the associations between intangible assets disclosures and non-capitalised intangible assets (measured in terms of market to book ratio).

The remaining of this paper is organised as follows. It proceeds with a section on literature review providing the definitions of intangible assets, discretionary disclosures, and intangible assets disclosures in general and in Malaysia. This is then followed by a section on the development of hypotheses. The subsequent section discusses on the research methodology employed in this study. The paper then analyses the findings and provides a discussion on them before concluding with some recommendations for future research.

Literature Review

Definition of Intangible Assets

Defining ‘unrecognised intangible assets’ is difficult (Brand Finance Report, 2008), however Guthrie et al. (1999) refers ‘unrecognised intangible assets’ as intangible assets which exist in reality but do not meet the definition of the intangible assets. These assets are mainly internally created or home grown by a business and they are not the result or consequence of a transaction or event (Tollington, 1998). Hence, these ‘unrecognised intangible assets’ are not identified, measured and disclosed in the conventional financial statements.

But, according to the Malaysian Financial Reporting Standard (MFRS) 138 Intangible Assets, ‘intangible asset’ is ‘an identifiable non-monetary asset without physical substance held for use in the production or supply of goods or services, for rental to others, or for administrative purposes’. In this paper, intangible assets are not only limited to those defined and recognised in accordance to MFRS 138 Intangible Assets. In other words, intangibles which are not capitalised in the balance sheets are also considered and examined in this paper.

There are three common categories of intangibles or intellectual capital, namely employee competence or human capital, internal structure or structural capital and external structure or customer capital (Sveiby, 1997). This paper adopts Davison and Skerratt's (2007) 12 intangible attributes which include elements from human capital, structural capital and external capital. In this paper, the terms, 'intangibles', 'intangible assets' and 'intellectual capital' are used interchangeably as practised by Gerpott et al. (2008), Vergauwen and Van Alem (2005) and Bozzolan, O' Regan and Ricceri (2006).

Discretionary Disclosure

According to Verrecchia (2001), managers or companies exercise discretion in terms of the disclosure of information about which they have knowledge in. Discretionary disclosure is expanded and it reports more than the mandatory requirements contributing to a greater transparency in transmitting firm-specific information to outside investors (Haggard, Martin and Pereira 2006). Hence, discretionary disclosure serves as an effective way for firms to communicate with their interest-related parties and stakeholders (Davison and Skerratt, 2007).

Intangible Assets Disclosures

Realising the lack of information on intangible assets reported in the conventional financial statements, efforts are made to increase and enhance corporate reporting on intangible assets. The American Financial Accounting Standards Board (FASB) (2001) has initiated a project on the disclosure of information about intangible assets that are not recognised in the financial statements. Van de Meer-Kooistra and Zijlstra (2001) found that attempts were made to incorporate intellectual assets and intangible resources into reporting.

According to Mouritsen et al. (2001), intangibles or intellectual capital disclosure is best communicated to both external and internal stakeholders via presentational materials like combining numbers, visuals and narrative statements to understand the firms' ability to create values. Davison and Skerratt (2007) found that companies in the United Kingdom disseminate information on intangible assets with the use of narrative reports. In their study, Davison and Skerratt (2007) have found that firms particularly those

with high intangible values use presentational materials to promote the intangible aspects of their businesses. Holland and Johanson (2003) who found intangible assets disclosures to be largely qualitative and nonfinancial to be helpful in improving the value relevance of financial information and they complement the financial information disclosed in the financial statements.

Studies on intellectual capital disclosures were conducted in many countries such as Australia, UK and Ireland, Sweden, Canada, Italy, Portugal, Sri Lanka and Malaysia. Most of these studies employed 'content analyses'. It was found that the level of firms' disclosures on the intangibles in the Portugal (Oliveira, Rodrigues and Craig, 2006), in the Italy and the UK (Bozzolan et al., 2006) are on the increase and such disclosures are mainly descriptive in nature. However, Guthrie et al. (2006) has found that intangible disclosures in Hong Kong and Australia are low and mainly in qualitative form. Disclosures in the telecommunications industry in Europe and the US (Gerpott et al., 2008) and in Spain (Macagnan, 2009) are often limited to minimal qualitative information. On the other hand, biotechnology firms in Australia do not disclose intellectual capital information well in annual reports (White et al., 2007).

Out of the three main components of intellectual capital, Bozzolan et al. (2006) found that the UK and Italian firms voluntarily disclose substantial amounts on the external capital. Portuguese firms disclose more organisational capital as compared to human and relational capital (Oliveira et al., 2006). Abeysekera and Guthrie (2005) found that human capital disclosure is higher in Sri Lanka as compared to the internal capital disclosure. Bournois and Point (2006) found that subsequent to employee information, customers are the next most frequently mentioned information in the president's letter. However, disclosure regarding consumers is completely ignored by most firms in Bangladesh (Imam, 2000).

Besides the above components, futureoriented disclosures are regarded as most valuable to readers (Santemaand Van De Rijt, 2001). According to Kent and Ung (2003), future oriented information is useful for investors in decision making as they are able to know the plans of the firms or their intention in the future. More future oriented information on intangibles should be disclosed in the annual reports to enhance the usefulness of accounting information.

Disclosures of Intangible Assets in Malaysia

The Malaysian government has taken various initiatives to shift its economy to knowledge-based economy. This shift has resulted in a greater consideration being given to the intangibles. Despite the requirements under MFRS 138 for intangible assets, the disclosure of intangibles in the Malaysian annual reports is still considered low (Goh and Lim, 2004; Foong, Loo and Balaraman, 2009; Huang, 2008, 2010). According to Huang (2008), this finding is not surprising as Malaysian companies are only beginning to realise the importance of intangibles in recent years. Furthermore, Brand Finance, a leading independent brand valuation consultancy, reported that Malaysian firms are undervaluing their intangible assets (Brand Finance Report, 2008).

In Malaysia, Goh and Lim (2004) revealed that the voluntary disclosure of intellectual capital in the annual reports of 20 top profit-making companies was mainly non-quantitative. All these companies reported information on their corporate culture, management philosophy and entrepreneurial spirit. Eighty percent were found to disclose work-related knowledge and work-related competencies. It was found that very limited disclosure was made on patents, copyrights, trademarks, franchising agreements, know-how and vocational qualification. However, the sample size of their study was small and only accounted for 2.4% of Malaysian listed companies at that time. Subsequently, Foong et al. (2009) found that the extent of voluntary intellectual capital disclosure among public listed companies in Malaysia is low and mainly narrative in nature with no systematic or consistent reporting framework.

Development of Hypotheses

Davison and Skerratt (2007) found that there is an association between discretionary disclosures and the values for intangibles. Brennan (2001) had argued that increased disclosure of intangible assets could reduce the gap between market and book value of the companies. According to Whiting and Miller (2008), firms with a gap between market and book value tend to consider disclosing intangible assets information voluntarily in other parts of the annual report in order to clarify the gap to their stakeholders.

Market to book ratio is often used to measure the gap between market and book value (Kannan and Aulber, 2004). Huang et al. (2010) has also used this statistic as a rough proxy for intellectual capital level of Malaysian companies. This measure is also used by Oliveras et al. (2004) to quantify the value of intellectual capital in their research. Therefore, this study hypothesises that companies with high values of non-capitalised intangibles assets as evidenced in their market to book ratios are more likely to disclose more intangible assets information. Therefore, the hypothesis can be expressed as follows:

H1: There is a positive association between non-capitalised intangibles assets (NIA) and disclosures of intangible assets.

Research Methodology

Sample

One hundred companies from eight different sectors were randomly selected from *Bursa Malaysia*. Table 1 displays the number of companies from each sector. These companies' 2008 annual reports were examined.

Table 1: Sample

Sectors	Number of Companies
Trading and Services	37
Infrastructure Project Companies (IPC)	6
Industrial Products	24
Construction	10
Plantation	7
Consumer Products	9
Properties	4
Technology	3
Total	100

Content Analysis

Employing content analysis, this paper examines 12 attributes of intangibles reported in the annual reports of 100 companies. These twelve attributes of intangibles are those of Davison and Skeratt (2007) as shown below:

1. Products.
2. Brands.
3. Markets.
4. Business/corporate development.
5. Consumers/customers.
6. Management.
7. Workforce/employees.
8. Corporate responsibility.
9. Corporate governance.
10. Quality.
11. History/reputation.
12. Future prospects/outlooks.

These attributes are deemed relevant as Huang, Luther and Tayles (2007) found that there is remarkable consistency between Malaysian data with other counterparts in the world in terms of intangible disclosures. In this study, the extensiveness of the disclosures of these 12 intangible attributes is reviewed in terms of occurrences. The frequency on occurrences is based on whether a given intangible is mentioned in a particular disclosure location.

As the disclosures of intangible assets are mainly voluntary in nature, disclosures from various sections of the annual reports (other than the financial statements) are examined. These reports/statements include the introductory narrative, chairman's statement, chief executive officer's (CEO) statement, directors' biographies (or equivalent), captions (phrases with pictures) and business reviews (or equivalent).

Findings and Discussion

Disclosures of Intangible Attributes

The occurrences of the 12 intangible attributes are displayed in Figure 1. This study found that out of the 12 intangible attributes, 'products' attribute has the highest number of occurrences (297) in the annual reports. This finding is consistent with that of Davison and Skerratt (2007), implying that 'products' are the most frequently promoted. According to Davison and Skerratt (2007), frequent reporting on 'products' companies help to promote the uniqueness of their products to the stakeholders.

The next highly disclosed intangible attribute after 'products' is the 'management' attribute with 286 occurrences. The lowest occurrences (57) fall on the 'corporate governance' attribute. This finding is also consistent with that of Davison and Skerratt (2007). The reason for the low occurrences could be due to the fact that corporate governance information has been discussed in-depth in the statement of corporate governance which is the statutory requirements of the Bursa Malaysia's listing requirements. This study does not examine the disclosure of intangible assets in the statement of corporate governance as it only focuses on voluntary disclosures.

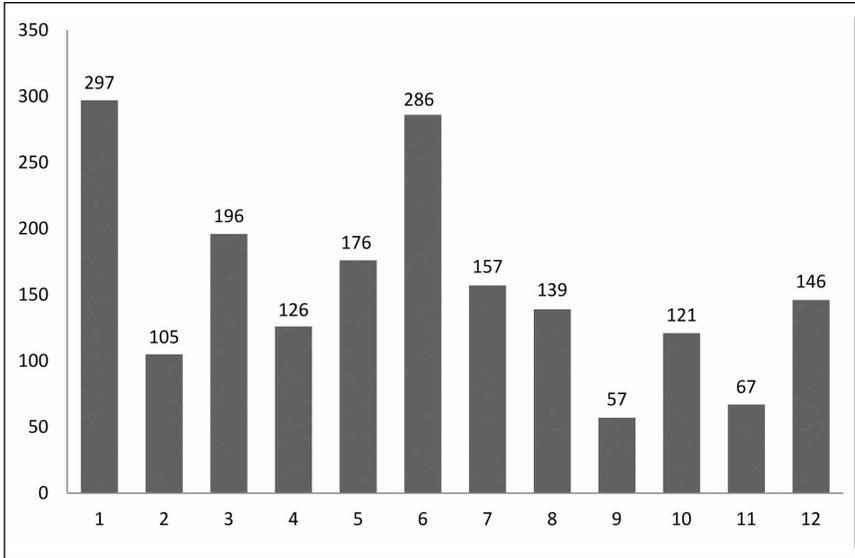


Figure1: Disclosures of Intangible Attributes (in Term of Occurrences)

- 1 = Products.
- 2 = Brands.
- 3 = Markets.
- 4 = Business/corporate development.
- 5 = Consumers/customers.
- 6 = Management.
- 7 = Workforce/employee.
- 8 = Corporate responsibility.
- 9 = Corporate governance.
- 10 = Quality.
- 11 = History/reputation.
- 12 = Future prospects/ outlooks.

Disclosures in Different Reports/Statements (Locations)

The occurrences of the above intangibles are further analysed based on their locations where the disclosures are found. Table 1 shows that the introductory narrative (DT1) reports of the most information on ‘products’ (50 occurrences). This attribute is also quite highly reported in the director’s biographies (DT2) and chairman’s statements (DT3).

Information regarding the ‘management’ is mostly reported (97 occurrences) in the director’s biographies (DT2). This attribute is also highly reported (87 occurrences) in the chairman’s statements (DT3). However, the least

frequently mentioned intangible attribute in director's biographies is 'future prospects'. As biographies mainly focus on directors, the 'future prospects' of the company may not be relevant in this section. Director's biographies contain information about the directors' past experiences, achievements and qualifications.

Future prospects/outlooks appear to be mostly reported in the chairman's statement (DT3). According to Trueman (1986), companies voluntarily disclose information on their forecasts or future prospects to show that they are aware of the firm's economic environment and are able to respond to changes quickly. Similarly, 'future prospects' attribute is most frequently featured in the CEO's statements. Though Campbell and Slack (2008) claim that CEO's statement is more useful than chairman's statement, Malaysian companies chose to disclose 'future prospects' information more frequently in the chairman's statement as compared to the CEO's statement.

In this study, disclosures in captions (DT5) are also examined. Captions in this paper are referred to as 'phrases accompanying with pictures found in the annual reports'. The 'products' attribute is the most frequently (40 occurrences) featured with pictures. According to Ho and Wong (2001), most companies disclose discretionary information in their business reviews. In this study, 39 occurrences reported information concerning their 'management' in business review.

Table 1: Occurrences of Intangible Attributes in Different Reports

Disclosure Types/IA Attributes	DT1	DT2	DT3	DT4	DT5	DT6	Total
IA1	50	81	73	16	40	37	297
IA2	16	17	24	10	15	23	105
IA3	36	23	72	15	16	34	196
IA4	5	22	58	6	25	10	126
IA5	37	9	71	15	14	30	176
IA6	24	97	87	16	23	39	286
IA7	33	14	52	10	25	23	157
IA8	21	4	55	8	36	15	139

Cont...

IA9	9	8	28	0	8	4	57
IA10	31	6	32	9	14	29	121
IA11	29	6	14	6	3	9	67
IA12	7	0	91	17	3	28	146
Total	298	287	657	128	222	281	1873

- IA1 = Products.
IA2 = Brands.
IA3 = Markets.
IA4 = Business/corporate development.
IA5 = Consumers/customers.
IA6 = Management.
IA7 = Workforce/employee.
IA8 = Corporate responsibility.
IA9 = Corporate governance.
IA10 = Quality.
IA11 = History/reputation.
IA12 = Future prospects/ outlooks.
DT1 = Introductory Narrative.
DT2 = Director's Biographies.
DT3 = Chairman's Statement.
DT4 = CEO's Statement.
DT5 = Captions.
DT6 = Business Review.

Out of the six disclosure locations, chairman's statement recorded the highest total occurrences that are 657 out of 1,873 occurrences (35.08%). In other words, in Malaysia, chairman's statement is the vehicle most frequently used to report intangible assets voluntarily. Consistently, Bartlett and Chandler (1997) state that chairman's statement and business review (or equivalent) attract a wider readership as compared to other disclosure types. Companies use these to meet the growing information needs of the shareholders and also to impress their shareholders and stakeholders, while CEO's statement is the least frequently used disclosure type (6.83%). In a research conducted by Campbell and Slack (2008) chairman's statement is generally considered to be less useful than the Chief Executive's Review because the latter is more likely (in most annual reports) to contain meaningful information on future strategy. But, Malaysian companies prefer to use chairman's statement to convey their intangible assets. This may not be in line with the International Accounting Standards Board's (IASB) intention to encourage narrative reporting in the management commentary.

Noncapitalised Intangible Assets (NIA)

Table 2: Non-capitalised Intangible Assets (based on Sectors)

Sector	Number of companies	Uncapitalised Intangible Asset (MTB per company)
Consumer Products	9	5.66
Infrastructure Project Companies	6	2.65
Plantation	7	1.84
Trading and Services	37	1.77
Construction	10	0.99
Industrial Products	24	0.68
Technology	3	0.57
Properties	4	0.35
Overall	100	1.75

Non-capitalised intangible assets (NIA), measured by the market to book (MTB) ratios, were extracted from Thomson One Banker database. Table 2 displays the average NIA per company according to sectors. Table 2 shows that companies from consumer products sector have the highest (5.66) market to book (MTB) ratio per company suggesting that much of their intangibles are not capitalised in the balance sheets. The property sector has the lowest market to book (MTB) ratio of 0.35 indicating that most of the intangibles are already recognised and capitalised. Technology companies also have rather low market to book ratios (0.57).

Association between Intangible Assets Disclosures and NIA

This section explores the relationship between the intangible assets disclosures and non-capitalised intangible assets. Since the data of this study is not normally distributed, non-parametric ranking tests, Spearman's rho was run. The result reveals that there is significant correlation between non-capitalised intangible assets and intangible assets disclosures ($r = 0.270$) at 95% confidence level. In other words, the frequency of occurrences on intangible assets disclosures is significantly and positively correlated with the non-capitalised intangible assets.

Even though the recognition of non-capitalised intangible assets is still debatable from the accounting perspective, this study found that companies with high market to book ratios tend to report more intangible assets in the annual reports. In other words, companies with high values of non-capitalised intangible assets engage more frequently in intangible asset discretionary disclosure, a means to communicate with their stakeholders to inform of their activities concerning intangible assets. This implies that Malaysian companies do attempt to narrow the gap (difference between market value and book value) to make non-capitalised intangible assets more explicit to their stakeholders by way of voluntary disclosure. As intangible assets disclosures are discretionary in nature, these companies have to utilise greater resources for collecting and presenting such information (Lang and Lundholm, 1993; Depoers, 2000; Rodrigues, Oliveira and Craig, 2005).

Conclusion and Recommendations

This paper has found that 'products' attribute is with the highest disclosure as opposed to 'corporate governance' attribute which receives the lowest disclosure. The chairman's statement appears to be the most popular vehicle used by the Malaysian companies to communicate their intangible assets. This could be because the chairman's statement attracts a wider readership (Lee and Tweedie, 1975). Hence, Malaysian companies prefer to convey their intangible assets via this statement. When association between intangible assets disclosure and - non-capitalised intangible assets is explored, positive association exists between them. This indicates that the higher the non-capitalised intangible assets, the greater the extent of intangible assets discretionary disclosures - are found in the Malaysian annual reports.

This paper extends on the literature regarding voluntary disclosures of intangible assets in Malaysia. It also provides empirical evidence on the use of discretionary disclosures as an alternative means to convey intangibles explicitly. With the greater demands on corporate reporting, Malaysian companies are pressed to disclose their intangible assets voluntarily providing a more transparent and complete picture of their companies.

Another observation from this study is that the accounting profession is faced with challenges in enhancing the reporting of intangibles. Companies currently have the discretion to choose what to disclose or what not to disclose about their intangibles. Consistent with the findings of Huang (2010), the disclosure content is not standardised, inconsistent and intangibles are reported at different locations in the annual reports. A more consistent and standardized disclosures would enable companies to make comparisons. According to Abeysekera (2008), a more uniformed approach in disclosing intangible assets is a necessary step forward to enhance the reporting of intangible assets. Beattie et al. (2008) suggests that regulators should consider more active intervention to ensure that the voluntary disclosures of the annual reports is more closely scrutinised to enhance value relevance. Ousama, Fatima and Hafiz Majdi (2011), claim that some guidelines on intangibles reporting should enhance transparency and increase confidence in the capital market.

Even though discretionary information disclosed in the narrative statements is regarded as important, these statements are not audited. Consequently, Davison and Skerratt (2007) claim that auditors and accounting practitioners pay less attention to information in such statements as they are not audited. Though discretionary narrative disclosures are proactive documents to move firms forward in achieving their objectives, such disclosures can only act as an effective means to convey information if they are audited (Smith and Taffler, 2000). Hence, the accounting profession needs to address this issue in addition to standardising narrative statements (Yuthas, Rogers and Dillard, 2002).

The Chairman's statement seems to be a popular means used by Malaysian companies to convey their intangibles. Hence, the contents of such statement need to be monitored closely. As operational and financial review and management commentary are now being considered as a supplement to corporate reporting, there is a need for Malaysian companies to identify relevant intangible asset information from the users' and management's perspectives. As reporting of intangibles is discretionary, Malaysian companies may communicate their intangibles in the management commentary as a step forward in supporting 'narrative reporting' as recommended by the International Accounting Standards Board.

One of the limitations of this study is it only examines disclosures of intangible assets in the annual reports. Future studies can explore disclosures beyond the annual reports like disclosures in the analysts' reports or in the prospectuses. Further investigation is needed to identify the types of intangibles to be reported before standardising such disclosures. Factors which explain the extent of discretionary disclosures should be explored to improve the reporting of intangible assets and ensure that only relevant information concerning intangibles is reported to the stakeholders. Only material intangibles information should be disclosed to avoid cluttering the annual reports with more information which is irrelevant for decision makers.

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