Accounting for Intellectual Property?

Roya Ghafele
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The silence of accounting
Accounting plays a significant role in shaping thoughts, beliefs, meaning, and action of market participants; it frames the way they understand and act with respect to a particular issue. Assessing how accounting approaches IP allows one to grasp how proprietary knowledge is being constructed and re-constructed through the filter of the various accounting statements. More than any other language, accounting serves to ‘normalize’ social and cultural business practice. Meanings of ‘patents’, ‘trade marks’, or ‘copyrights’ in various business contexts arise in the context of a network of signs, messages, and images, which under current accounting standards, privilege the communication of tangible items over IP.

While IP commercialization reinforces many of the arguments made by the resource-based view of the firm, accounting does not allow linguistic reflection on these business strategies. The various business options made possible through IP law can hardly be expressed through current accounting systems since accounting primarily gives recognition to IP associated with licensing transactions. Thus only IP that is clearly associated with direct revenue streams can be expressed through the language of accounting. This means keeping silent about all other forms of IP-based business relationships, particularly for IP that is used and generated internally.

Because historically accounting evolved as a double-entry book keeping tool to track and document the exchange of tangible items, accounting has difficulties in grasping IP, which does not necessarily fit the socio-historic evolution of accounting. The following example illustrates how current accounting statements are precise but may lack practical significance in an increasingly knowledge-based economy:

At a U.N. conference on the reflection of intangibles in systems of national accounts (UNDESA, 2006) a representative of the U.S. based Securities Exchange Commission assessed the 2005 acquisition of Gillette by Procter & Gamble. The purchase price for Gillette was at 57 bn USD, whereas the reported net book value of the firm was at 3.5. The SEC found that Gillette had fully complied with current accounting standards, which led the SEC’s representative to ask to which extent current accounting standards still met the reporting needs of intellectual property rich firms; In the case of Gillette the major value derived from its trade mark protected brands, such as Gillette razors, Duracell batteries and Braun and Oral-B dental care products.

Key issues
- Accounting constitutes a very specific form of language, which is highly standardized, mathematical in nature and seeks to uniformly and systematically describe events while avoiding expressions of individual creativity or explicit political positions. In this sense, accounting is a social, cultural and historical artefact rather than a natural or technical phenomenon and can therefore be viewed as the decisive instrument to create and maintain imagined business communities.
- On the balance sheet, IP experiences a specific form of authorization. It is represented in the discourse of accounting by ‘intangibles’, an imprecise term associated with the increasingly observed ‘gap between the market and book value’, while current accounting systems are determined by a tangible assets’ based perspective and offer little scope to document how IP relates to business performance.
- Accounting may thus be seen as a gate keeper of the status quo that poses significant challenges for IP-rich companies, confronted with the challenge to either communicate around the lingua franca of accounting or accept that under current accounting statements they cannot adequately document how IP relates to their business performance.

* University of Oxford. Email: roya.ghafele@qeh.ox.ac.uk.
Clearly, the various challenges associated with determining the value of internally held IP, paired with the inherent volatility associated with the value of some forms of IP, can be cited as major reasons why accountants have been reluctant to report fully on IP. Yet reasons for accountants’ reluctance to embrace the concept of IP are deeper than that and may be better understood in light of the conceptual differences between the accounting and the IP community. The purpose of this article is to illustrate empirically how accounting shapes a very particular perception of IP, which in turn may hamper the full commercialization of IP. The article first discusses IP from a business perspective and explains the various ways that IP can be commercialized. I then turn to accounting and assess it from a linguistic perspective, to explain how accounting contributes to shaping specific business realities and dismantle systems of seemingly ‘fact-based’ accounting statements as social constructions that reinforce a particular understanding of firm behaviour. This perception is based on two inherent assumptions, namely that tangibles rather than intangibles contribute to business performance and that business depends largely on an arm’s-length transaction between a willing buyer and a seller. Neither assumption matches the nature of IP. In the empirical part of this article, I pick a couple of key examples, such as the notions of ‘goodwill’, ‘fair value’, or ‘intangible asset’, and explain how a specific understanding of IP is being created through the vocabularies that the language of accounting offers. I conclude by explaining the social implications this peculiar form of communication has and call for further empirical research to discuss the phenomenon in greater depth.

**IP commercialization**

Successful IP commercialization entails product/service development, production, and distribution. However, an IP owner does not need to possess all these capabilities—or complementary items—within the organization. Some of the essential questions of IP management concern which capabilities to possess, acquire, or build inside the organization and which capabilities to leave to a partner. These strategic steps are facilitated through inherent features associated with IP, which makes knowledge explicit and allows the exchange of codified information. Thus one may argue that IP makes knowledge economically functional and managerially controllable: it may be viewed as ‘knowledge in action’ or a right in an abstract object. IP determines the way in which knowledge relations are governed and therefore emerges as an essential organizational principle of the knowledge-based firm. IP protects products of the human mind and is generally categorized into patents, trade marks, industrial designs, geographic indications of source and copyright, including literary and artistic works.

Because by nature IP is knowledge, IP shows non-rivalry in consumption and only partial excludability. This means that IP can be used by various business partners at the same time without decreasing substantially in its value. The relevance IP has to a business is furthermore shaped by the overall business context and background of the user, features that stand in strong contrast to tangibles. A trade mark for a well-known consumer product (ie a Gucci handbag) may have little value to a biotechnology company. A lot of the IP that a company owns has an indirect impact on its cash flows. For example, IP protection often provides a firm exclusivity in the relevant market and/or the ‘freedom to operate’. IP is used by firms to block products of competitors, as a bargaining chip in cross-licensing deals, and to prevent or defend themselves against infringement suits. Other reasons may be the prevention of copying, earning licence revenue, strengthening of the firm’s position in negotiation with other firms, or enhancing a firm’s reputation. IP is also leveraged as part of an effort to allocate rents between different levels of production or development. Further, IP allows players to sell, buy, trade, or licence knowledge that has been made explicit and codified through the judicial system. It has an impact on a firm’s services or products, its business processes, know-how, or tacit knowledge.

IP protects the various business segments of a firm, ranging from the looks of its products and packaging (industrial design), to its recognition in the market (trade marks, geographical indications), to the protection of the new or improved functional features of products and services (trade secrets, patents).

It is primarily the winning interplay of these different factors that can create cash flow for a firm. IP is thus a primary strategic tool and can be a decisive factor for a


6. ibid.

firm’s competitive advantage and survival in the 
market.8 Or, as has been observed,9 firms only survive 
if revenues are large enough to cover costs. This largely 
depends on the firm’s ability to learn about new pro-
ducts and optimize the cost function. A firm’s com-
petitive advantage lies therefore largely in its capacity to 
manage its strategic resources, which are in many 
instances protected through IP law, rather than tangible 
in shape and character. While the latter may provide 
the business context, the former are the driving factor 
of business in markets for ideas. This is in line with the 
resource-based view of the firm, which argues that a 
firm enjoys a competitive advantage if it controls phys-
ical, human, or organizational wealth that is valuable, 
rare, inimitable, and non-substitutable. It is the unique 
interplay of these resources that gives a firm its com-
petitive advantage.10

Accounting: the language of business11

Parker (1992) defines language as a set of statements that 
bring social objects into being. In this sense, accounting 
may be viewed as a language.12 Through accounting, IP 
experiences a specific form of authorization. Life is 
brought to IP by providing a system of stable semiotic 
orders, otherwise known as linguistic order, to commu-
nicate about IP. With respect to IP, this specific discursive 
selectivity serves a specific reproduction of complex 
socio-economic orders, which can currently be best 
described as the ‘defensive rights’ paradigm of IP law.

Because accounting is a language, it conveys what is 
‘meaningful’ and ‘real’ in business. Since it provides 
market participants with a limited inventory of signs, 
structures, vocabulary, and syntax, it allows market par-
ticipants to communicate about business performance. 
Accounting determines ‘what is and what is not’, ‘what 
can and cannot be done’, and ‘what should and what 
should not be done in business’.13 Without officially 
recognized systems of accounts, specific business per-
ceptions and understandings could not be maintained. 
The linguistic practice of accounting allows members 
of the business community to engage in the construc-
tion of a complex and diverse system of meanings.14

An accounting system serves as a mechanism of lin-
guistic exchange with participatory mechanisms that 
provides information, clarifies possession and use in 
business transactions. Accounting provides a system of 
shared meaning through wide, heterogeneous symbolic 
engineering and circulation. Accounting is an artificial, 
highly mathematical language that seeks to be free 
from cultural connotations by following the strict code 
of a standard, officially sanctioned and recognized by 
the state, and, increasingly so, by the international 
community. Accounting forces market participants, 
particularly if quoted on the stock exchange, to ‘speak’ 
about business performance in a highly standardized, 
ritualized way. Creativity of expression is to be by all 
means avoided and the officially codified linguistic 
order to be applied to address business transaction.

Because accounting enjoys a high level of official 
sanction, like Latin in the Christian Church, it has sig-
nificant power in shaping certain understandings of a 
subject and turn it into generally accepted truths. 
Certain positions are legitimized, while others are dis-
credited, nullified, or excluded.15 For that reason, 
accounting constitutes the symbolic dimension of 
business, a major feature that an intellectual capital 
report cannot provide since it neither enjoys the same 
claim to truth nor the same level of official recognition. 
Thus the firm may be viewed as an artefact of account-
ing production. The distinction between the agent and 
the network collapses and, as can be shown for the 
accounting of IP, the capacity of social agents to radically 
transform organizational structures is very limited.

Accounting ‘arranges’ markets in a specific way, by 
arranging information in a specific way, thus underlining 
Berger and Luckmann’s (1967) argument that language is 
the constitutive element of social representations of 
reality.16 The ‘natural’ and the ‘social’ worlds differ, in 
that the reality of the social world needs language to 
produce meaning and make sense of the world, while the 
natural world can and does exist independently from the 
linguistic activity of humans. The socially ‘real’ is differ-
ent from the ‘empirical’, the ‘actual’, which belongs to the 
domain of events and processes. Foucault would argue

8 J Spender, ‘Making knowledge the basis of a dynamic theory of the firm’ 
9 DB Audretsch and E Lehmann, ‘Financing high-tech growth: the role of 
Mavrinac and T Boyles, ‘Sell-side analysis, non financial performance 
evaluation and the accuracy of short-term earnings forecasts.’ Ernst & 
11 S Davidson, Accounting: The Language of Business (10th edn, Thomas 
13 N Phillips and C Hardy, Discourse Dynamics—Investigating Processes of 
14 D Mumby and C Stohl, ‘Disciplining organizational communication 
studies’ (1996) 10(1) Management Communication Quarterly 50–73.
15 S Jäger, Text und Diskursanalyse, Eine Anleitung zur Analyse politischer 
Texte (DISS: Duisburg, 1994).

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that the ‘real’ depends on the ‘actual’ and therefore does not fully constitute a world on its own. Yet, by introducing the notion of ‘representation,’ he argues that linguistic realities are the only elements of a social reality that human actors can grasp. As socially (re)produced actors, firms can, however, only experience the ‘socially real’ and not the ‘actual.’ The primary filtering mechanism that allows firms to experience the socially real is the accounting system. The resulting patchwork of practice forms the social network of a specific group, the ‘imagined business community.’

This approach finds reflection in Barthes’ concept of myth. By introducing the notion of ‘myth,’ Barthes depicts a system of facts that seems to derive its sense ‘naturally’ from the objects themselves, but is in fact the result of a specific ‘myth’ that ‘naturalizes’ what is actually of historic nature. This is how the ‘myth’ escapes critique. Accounting does not just simply map business, or objectively mirror an existing, pre-defined business context; rather, it creates that business context by offering a complex system of representation. Accounting as a discursive practice is not descriptive of business operation, but actively categorizes and combines operations in specific ways that make sense in the language of accounting, but do not necessarily help to grasp, communicate, and improve IP commercialization.

**Accounting for IP?**

With respect to IP, accounting clearly differentiates what one can say, what one must say, and what one has to be silent about. Accounting remains silent in many instances where IP plays an important role in business. We thus support Rodov and Leliaert’s (2002) argument that accounting is dominated by traditional factors of production and ignores the importance of proprietary knowledge as a factor for wealth creation or destruction.

While it is hard to document silence, the untold story of IP may often be more conducive towards the creation of certain business communities than the story that accounting eventually tells. The following empirical illustrations of the various ways in which accounting approaches IP do not claim to offer a complete overview of how accounting approaches IP. I concede that each single vocabulary and grammatical structure that accounting provides for IP could fill an entire compendium of analysis in itself. Yet, because so far no attempt has been made to grasp how IP is being con-structed through accounting, I believe it is fully legitimate to provide a snapshot of the most prominent linguistic constructions so to show the disequilibrium between the language of accounting and the business context made possible through IP.

The following assessment of how the two most internationally recognized accounting systems, the US Generally Accepted Accounting Principles (USGAAP) and the International Financial Reporting Standards (IFRS) allow to communicate about IP is the first of its kind and it is to be hoped that further analysis on that issue will follow. I look at these codes through a linguist’s lens and assess at the example of the differentiation between ‘internally generated and acquired IP,’ the notions of ‘goodwill’ and ‘fair value’ how and to which extent it is possible to speak about IP within the existing grammar structure and vocabulary. In doing so, I build upon a series of presentations that I gave at the following conferences.

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<td>Oxford Intellectual Property Research Centre</td>
<td>Oxford</td>
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<tr>
<td>20 April 2007</td>
<td>University of St Gallen. Department of Entrepreneurship and Innovation</td>
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<td>14 July 2006</td>
<td>United Nations Department of Economic and Social Affairs. Statistics Division</td>
<td>New York</td>
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<td>22 May 2006</td>
<td>5th Intellectual Property Management Gathering. ICMG Gathering</td>
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<td>27 September 2005</td>
<td>European Trendworkshop for Innovation. European Commission</td>
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Following some basic Delphi methodology, the respective grammar structure and vocabulary analysed below was presented in a series of oral presentations and comments on online blogs to the interested community and subsequently amended, modified, and adjusted, following the feedback received. Most prominently I posted my observations on accounting and IP at the following blogs:

- Know IP: [http://issuu.com/stockholmnetwork/docs/know_ip_34](http://issuu.com/stockholmnetwork/docs/know_ip_34)

These triggered some vivid discussions. The cumulative observations of the readers and seminar participants are reflected in the empirical part of this article.

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Grammar structure: how IP is being reflected depends primarily on the business context

Currently, internally generated and acquired IP is treated differently. Internally generated IP is immediately expensed, appearing thus as a loss rather than a revenue. These costs are furthermore only reported at one single point in time. Silence thus prevails when one attempts to understand how IP is generated. IP is considered a cost and immediately expensed and equally reported only at one single point in time. Says Caroline Kammerbeek, Head of Communication at Philips IP & Standards:

For a long time Philips IP & Standards had to struggle so not to be seen as a cost center. With all the R&D and investment in patents, the board very much perceived us as a major source of costs, rather than a driver of the bottom line of Philips.20

It may thus be a challenge to trace how IP-based research and development, design, or brand innovation has been generated, with significant consequences for the financial position, as well as the managerial competences of IP intensive firms. Acquired IP, to the contrary, is recognized at the purchasing price and amortized accordingly (ie 40 years under USGAAP).

This grammar structure creates a series on inconsistencies. Consider the case of a film maker. The major value of that firm derives from the ownership of copyrights associated with a movie. Yet the same copyright portfolio may appear to be worth nothing (if internally generated) or worth a fortune, if associated with a market-based transaction. If that film maker decides to licence or sell the rights to its film, it will appear to generate revenues literally out of nothing. In practice, this has created certain disadvantages for IP-intensive firms. London-based ‘Mediafinance Group’, for example, reported that banks refused to make a significant loan for a film project available because the driving factor, copyright, appeared as a loss on the profit and earnings statement.21

This underlying rationale is not exclusively reserved to the accounting of IP, but reflects the way accounting in general enables business to communicate its financial position. The double entry accounting system accepted globally underpins the notion that business transactions constitute a unique and identifiable exchange of items that result in equal credits and debits.22 The various forms of IP commercialization thus clash with a century old linguistic paradigm that derived its primary rationale from the business reality that the Renaissance merchants of Venice faced. Yet, in today’s knowledge intensive sectors, driving factors of business are neither limited nor necessarily based on an arm’s-length transaction between a willing buyer and a seller. Value is to a large extent generated through internally held patents, designs, trade marks, copyrights, or trade secrets and may not necessarily be directly related to a business transaction.23 It is the institutional context provided by IP that can offer a firm a unique competitive advantage.

By 2005, the World Intellectual Property Organization (WIPO) recognized that the specific grammar structure of current accounting standards appears insufficiently equipped to address the IP dimension of business. WIPO made, however, with the following restriction:

Clearly, the various challenges associated with determining the value of internally held intellectual property, paired with the inherent volatility associated with the value of some forms of IP can be cited as major reasons why accounting has been reluctant to report on internally generated IP, which is seen as too subjective and risky. Furthermore, accounting has always been reluctant to anticipate future gains, overstate the value of assets or include assets on the balance sheet whose value is more volatile.24

Yet reasons for further investigations into that subject matter seem more complex, and particularly more political than this seemingly fact-based argument suggests. Most recently, the initiative of the Australian Government to deepen further research on this issue was not accepted by other members of the IFRS, primarily because certain associations were concerned with tax implications for its members associated with addressing this inconsistency.25 Nonetheless, the political struggle towards further recognition of IP through accounting is evolving, as the following chart illustrates. More conservative accounting regulations, such as the Austrian and German Commercial Code rule out the recognition of IP, unless acquired.26 Much of
the IP held in a knowledge-intensive firm will, therefore hardly be communicated about. At the more progressive end of the scale, we find jurisdictions, such as the USGAAP, that allow for a more differentiated communication with respect to acquired IP.


‘Goodwill’: a vague vocabulary

For many years, goodwill was the only vocabulary to address IP. The terminology is, however, inherently misleading with respect to IP. Within the accounting profession, there is a vivid discussion whether goodwill can be treated in mere residual terms.27 This is associated with complex discussions over the conceptual dominance of the income statement versus the balance sheet.28 Recent decades have seen an emphasis on the income statement as the driving statement with a significant concern for appropriately matched costs and revenues, and a reluctance to capitalize IP costs against uncertain future revenues. The increasing shift towards a balance sheet (Hicksian) notion of the income seen in increasingly wide ranging ‘market to market’ accounting re-emphasizes the need to capture ‘well-offness’ deriving from intangible sources. For a comprehensive discussion of the effects of the recent crisis on such accounting, see Laux and Leux (2009).29 This sketches only the contours of a deep and extensive set of debates, yet with respect to IP, the concept of goodwill is fairly vague, because anything that can justify a higher price for a firm may be lumped together under goodwill. For market participants, be they managers or investors, this wording makes it really hard to compare the goodwill of various companies or understand how various forms of IP relate to business performance. Because market participants depend on language to communicate to each other and to understand their own position in the market, the vocabulary of goodwill has made various strategic and financial IP-based operations a challenge. Because goodwill lumps together anything ranging from a customer base to a trade mark and because each firm summarizes different intangibles under the term goodwill, it is a real challenge to make educated business decisions based on accounting statements.

So far, only in one specific area of business transaction, mergers and acquisitions, has the terminology of goodwill been redefined, in one internationally recognized jurisdiction, the USGAAP. Financial Accounting Standards (FAS) 141 and 142 of the USGAAP require a more explicit understanding of the role IP has for business. Rather than simply adding the goodwill of two firms, ‘goodwill of firm A + goodwill of firm B = goodwill of firm C’, technically described as the ‘pooling of interest for business combinations’ method, merging firms are asked to identify each single acquired asset and account for it at its fair value. Subsequently, the overall purchase price must be distributed across all business items qualifying as assets. FAS 142 abolished the amortization of goodwill. Firms are asked to review on a yearly basis acquired IP and conduct an ‘impairment test’.30 In the context of M&As, the USGAAP has thus been able to recognize the explicit value of IP and attribute or associate a specific quantitative statement to a specific form of IP. It remains to be seen to what extent the IFRS, which asks for the amortization of goodwill over a period of 20 years, will be able to adapt to the steps taken under the USGAAP.31

‘Intangible assets’ and ‘fair value’: vocabulary as gatekeeper

Coca-Cola has kept the trade secret over its syrup since 1891. Paired with successful trade mark management, the company’s trade secret has made up for most of its profits since the nineteenth century. Yet, under current definitions of intangible assets, Coca-Cola’s trade secret does not qualify as an intangible asset. While in economic terms, IP can be classified as an intangible asset, current accounting standards only allow certain forms of IP as an intangible asset.


States IAS 38: ‘An intangible asset must be identifiable, controlled by an enterprise as result of past events and should generate future economic benefits for the enterprise’.32

A highly significant aspect of this formal definition is that ownership is not the issue, rather control is. Thus the nature of assets brought about through finance leases is a decisive factor. This means that only IP that is associated with direct revenue streams, such as a licensing agreement, qualifies as an intangible asset, and even progressive judicial reforms, such as the introduction of FAS 141 and 142, only apply to such form of IP. Internally held IP, IP held for defensive purposes, embedded IP, or contextual IP does not qualify as an intangible asset and therefore must not be given further consideration in accounting. Defining only IP that has direct revenue streams as intangible assets means mentioning only a fraction of IP-based business strategies, while keeping silent about the value added by much of a company’s other IP.33

The vocabulary ‘intangible asset’ triggers the phrase of the ‘gap between the market and the book value’, which can be seen as yet another expression of a lack of adequate means to communicate about IP. While a range of authors studied and documented the increasing gap between the market and the book value,34 the observation provides little information on IP-related business performance. First, the market value is based on information given in the books (and is thus a circular statement); secondly, the market value reflects a common perception of the market of a company, but may say little on how a firm leverages IP for profits.35 When it comes to the concern over book to market ratios, even a complete inclusion of intangible assets would not remove the gap completely, since the gap is there because of the nature of any asset (tangible or intangible) as a subset of an entity which may have an overall market value.36 If anything, the sentence ‘gap between the market and the book value’ shows how ill-equipped the language of accounting is to deal with IP.

To determine the value of IP accounting refers to the notion of ‘fair value’. Fair value is defined as the amount at which an asset could be bought or sold in a current transaction between willing parties, other than in a liquidation.37

The notion of ‘fair value’ is underpinned by a benchmark approach, which is not the most adept way to reflect the value IP has to individual business performance. Referring to the resource-based view, one can illustrate that the ‘value in use’ of IP can range from providing a firm with the right to exclude to offering new opportunities of trading its products and services. Laux and Leuz (2009) offer a compelling discussion to which extent fair value accounting fits its purpose, yet no mention can be found of IP.38 Rescher (1969) argues further that value is not a feature inherent in an item. Rather, items may have value because they are in some way desirable to someone.39 The concept of value therefore comprises some sort of utilitarian purpose. Crosby (1997) again states that the notion of value is inherently benefit-oriented, reflecting what a firm considers a desired output.40 In many instances, it is the winning interplay of various IP-protected business segments that help a firm succeed in the market. Because by nature IP is knowledge and creativity, context, background, and business strategy are decisive drivers of value. Markets for IP are also opaque and not well developed. In many instances, IP owned by one firm could be of value to another firm, yet because of a lack of adequately developed trading platforms for IP, these exchanges do not take place. Much IP therefore sits gathering dust. This was already recognized by the Basel Committee on Banking Supervision, as early as in 2000:

In the absence of active markets it will be difficult to obtain or calculate a reliable fair value for certain non-marketable financial instruments held at cost...it concluded that it does not believe the time is right to...
proscribe full fair value accounting...for all financial assets and liabilities.41

Finally, innovation is by its very nature not suitable as a benchmark. An innovative product or service that can be compared with products or services or services already in use does not deserve to be called ‘innovative’. So far, accounting seems to have taken little steps in valuing IP for what it is, rather than pressing it in a tangible assets’ based paradigm that does not correspond to its features.

The impact of linguistic accounting gaps on business

Because business is a social practice that is constructed, created, and maintained through language, the linguistic disorders provided by accounting for IP create various shortcomings and confusions when dealing with IP. Most prominently, the management of IP, and also the potential to attract funding on the basis of IP, may be hampered by the limited way in which accounting addresses IP.42 The disqualification of most forms of IP through stringent criteria associated with the terminology of ‘intangible asset’ means that a firm’s earnings as well as book value of equity are ill reflected.43 Again, the following illustrations may be read as a pars pro toto (as a part of the whole) of the entire spectrum of business behaviour hampered by this form of language, yet serve as a solid illustration how the language of accounting impacts business practice with respect to IP.

Can you manage what you cannot measure?

While Stewart (2001) argues that ‘you cannot manage what you cannot measure is one of the oldest clichés in management since companies have always managed things—people, morale, strategy—that are essentially unmeasured’, he ignores the overall social function of accounting, which shapes a very specific understanding of a business.44 The management of a company becomes a much greater challenge since adequate information on all the assets and liabilities of a company are not available. The internal management of IP is seriously hampered since its value is not made explicit through accounting. Since the bulk of the space of accounting statements is devoted to tangibles, managing IP becomes a very intangible undertaking. Managerial efforts may at best be indirectly reflected, but do not become directly visible. The lack of visibility of IP through accounting systems makes it very difficult for management to shift the focus to developing adequate IP strategies. After all, bottom line results need to be delivered, yet in the case of IP these will hardly find any reflection in the officially recognized language of business. The chart below illustrates the various advantages and disadvantages of adequately reporting on IP form managerial purposes.45

Can you finance what you cannot measure?

Lev (2000) has proven that the price of a technology stock is positively related to the firm’s efforts to announce licensing agreements, royalty revenues, patenting activities, and viable technological developments.46 Since IP is literally absent from the accounting, reporting, and managerial discourse, investors find it difficult to access information on how a firm’s IP portfolio relates to its income streams. For this reason, risk rates associated with investments in knowledge-intensive sectors may not be adequately assessed and a higher premium may be charged when funding is provided on the basis of IP. Since investors ask for a premium in deals where risk rates cannot be fully determined, the costs of borrowing money increase for the IP intensive creditor.47


46 Above note 23.

47 Above note 7.
gains in firms with heavy R&D were more substantial than those with fewer R&D activities. Since IP and its underlying R&D is poorly disclosed, insiders can easily manipulate information about planned changes in R&D budgets. Within that context, Lev furthermore argues that the volatility of technology stocks is further nourished by accounting standards that make it hard for investors to track how innovation relates to business.48 The chart below illustrates the various advantages and disadvantages of adequately reporting on IP form managerial purposes.49 Finally, the overall lack of awareness on leveraging IP as an asset class is furthermore stipulated by current accounting standards. IP securitizations, such as the securitization of the copyrights of Annie Leibovitz’s photographs or David Bowie’s songs are all considered ‘off-book’ deals.

Already in 2001 the FASB for example stated that: ‘Companies are encouraged to continue improving their business reporting and to experiment with types of information disclosed and the manner by which it is disclosed.’52

The Sarbanes Oxley Act, passed by US Congress in 2002, aimed to overcome reporting scandals such as those of Enron or Worldcom. With respect to IP, the act asks publicly traded companies to increase their reporting on internal control structures and procedures for financial reporting. IP that has a material effect on financial performance needs to be disclosed.53 Thus valuable intangibles, such as trade marks or domain names, need to be disclosed. The Act furthermore asks businesses to identify, measure, and disclose risks associated with IP, such as potential litigation or expiration of a patent. In doing so, it does, however, not go further than FAS 141 and 142. Thus the Act asks for a documentation of the ‘fair value’ and not the ‘value in use’. It also adheres to the generally accepted definitions of ‘intangibles’.54

Core to accounting’s reluctance to fully embrace the concept of IP are certainly issues surrounding the adequate valuation of various forms of proprietary knowledge. There is no way to introduce any form of valuation method that goes against the underlying principles of accounting. Yet it is both insufficient and unsatisfactory to assume that the current context cannot be changed or modified. With respect to various forms of IP, certain valuation techniques have proven to be useful instruments. Valuing rights to exclude is difficult, but it can be done using a variation of the Black–Scholes equation for pricing stock options.55 No doubt, more research is needed to better...
understand the dynamics of IP in business performance so to better grasp how to account for it.

Questions that deserve further empirical underpinning are issues such as whether market participants do find a way to ‘communicate around’ the lingua franca of accounting so to communicate the role IP plays in business or if to the contrary, market participants themselves are so strongly embedded in the linguistic reality as designed by accounting that they cannot escape the overarching discourse of silence. In that case, we would see a circular reinforcement of the current situation. It will also be worthwhile exploring empirically to what extent FAS 141 and 142 shaped a different awareness on IP among market participants and whether we can observe some spillovers to other business situations. From an innovation policy point of view, one may also ask what alternative public policy measures may work to foster the financing of innovation and overcome existing reporting asymmetries with respect to IP. The range of questions worthwhile deepening is wide; in that sense, this paper offers nothing, but a preliminary outline, a scratch on the surface of the type of reporting dilemma we face in the knowledge-based economy. Social more than technical by nature, the lack of awareness on IP reveals the blind spot of a primarily modernist business culture. Apparently, what is needed is more than mathematics: a business culture that deals with IP in the same ‘natural’ way as it does with machinery and other tangible items. It is self-explanatory that a paper illustrating the various conceptual differences between accounting and IP is very much the first of its kind, suggesting that bringing the IP community closer to the accounting community would benefit the current state of the play. Current approaches lead to distortions in markets for IP, which can only be counteracted by making the invisible visible, the intangible tangible, and the unspoken outspoken. If accounting is to remain relevant, it needs to capture the behavioural dynamics of IP, assess the impact of IP on organizational economics, and tell a more comprehensive story on the relationship between the past and the future by finding ways to systematically identify and map all of a firm’s assets and liabilities, be they tangible or intangible in nature.