



THE MISSING LINK

WHILE INTERNATIONAL FINANCIAL REPORTING STANDARDS HAVE IMPROVED TRANSPARENCY, THEY HAVE ALSO BROKEN THE TRADITIONAL LINK WITH MANAGEMENT ACCOUNTING PRACTICE. JUERGEN DAUM ARGUES THE CASE FOR INTERNATIONAL MANAGEMENT ACCOUNTING STANDARDS.

The finance community has been concerned for many years about the absence of global accounting and financial reporting standards to help compare the financial statements of companies from different countries.

The International Accounting Standards Board (IASB) has gone some way towards rectifying this situation. Its mission is to develop a single set of high-quality, understandable and enforceable global accounting standards: the international financial reporting standards (IFRS).

Sir David Tweedie, IASB chairman, believes: 'There isn't any reason why a transaction in Boston should be accounted for any differently than one in Brussels or Brisbane. And if they are accounted for in the same way, it's going to open up the capital markets. Say you are on Wall Street, reviewing a Dutch company. You'll have other things to think about, but accounting is not going to be one of them. That's going to reduce cost of capital. That will save a lot of money.'

IFRS went live on 1 January 2005. However, this is far from mission accomplished. To begin with, there is the widely acknowledged problem that IFRS are a moving target, due to the ongoing process of releasing new/revised standards. There is also the issue of a convergence gap between IFRS and the generally accepted accounting principles (GAAP) in the US.

Lost connection

Another serious and almost entirely neglected aspect is that managers and auditors also need standardised and reliable internal controlling and management accounting data to support IFRS. This is essential for supporting management in their decision-making and steering their organisation towards the IFRS-based performance concept, as well as supporting IFRS-based financial accounting and facilitating 'fair value' valuation of goodwill and intangible assets.

IFRS represent a major step forward for transparency and comparability of companies from an investor perspective. However, we are still failing to acknowledge

the links between traditional, local financial accounting standards or GAAP and locally developed management accounting practices.

These links reflect practices that have been developed over decades in companies and management accounting/controller communities

‘MANY OF THE PIECES REQUIRED FOR A COMPREHENSIVE REDESIGN AND REDEFINITION OF MANAGEMENT ACCOUNTING AND CONTROLLING ALREADY EXIST. THEY JUST NEED CONSOLIDATION.’

in different countries. They ensure that companies have analytical data to support decision-making and performance management that are in line with financial accounts and the performance concept used in external reporting (based until recently on local GAAP). They are also the foundation for valuing certain financial statement items, such as inventories based on cost-accounting data.

IFRS and its fundamentally different accounting philosophy has broken these links through the introduction of a new era of financial accounting and reporting based on the previously unknown ‘fair value’ principle, which meets the international investors’

requirements. This is very different from traditional concepts such as the continental European ‘prudence principle’, which protects local creditors.

CALL TO ARMS

WHY THE WORLD NEEDS MANAGEMENT ACCOUNTING STANDARDS

Globalisation

As businesses become increasingly international, they need standardised controlling and management accounting concepts across their national operations to create a common internal ‘language’ for decision-making and performance management. New management accounting best practices and concepts, which have evolved in a national context, now need to move up to an international level. This is comparable to the way that IFRS have enabled financial statements to be transparent and comparable for investors across national borders.

Antiquated processes

Traditional management accounting concepts, which form the basis of most controlling and management accounting systems, are failing to support today’s managerial decisions and the valuation of corporate assets. This is because these instruments, which focus on cost accounting, were established practically a century ago when the main value creation process was mass production. Today, value is created through a wide variety of activities, such as in sales and marketing, research and development, or the creation of new business models and mergers and acquisitions. No concepts or instruments have been developed to support management accounting and decision-making in this new world of value creation that can match the rigour of the traditional concepts that supported the mass-production model. General managers have practically no support from a management accounting/analytic perspective to enable them to make optimal trade-off decisions that help their companies create fundamental value-added in the future. New concepts, such as the balanced scorecard, which provides a holistic view of the value creation system, are leading in the right direction, but are only a small first step. We have to move to the next level in management accounting, controlling and decision support – and fast.

Creating best-practice standards

Management accounting cannot be standardised in the same way as financial accounting. In this context, standards refer to a common approach rather than fixed, mandatory rules. Common best practices need to be shared, and international management accounting standards (IMAS) should represent best-practice standards for management accounting and decision-support systems in a specifically managerial context. Such standards are already being established in practice: multinationals are widely standardising their management accounting and controlling across the entire corporation, resulting in de facto best-practice standards that will eventually affect all companies. At this stage it would be helpful if the controller/management accounting community joined forces on an international level to advance the discipline in a more organised way, thus avoiding duplication of effort.

REGIONAL DEVELOPMENTS

- **France:** *tableau de bord* (the French version of the balanced scorecard, which has been practised for over 40 years)
- **Scandinavia:** intellectual capital statements
- **Germany:** *grenzplankostenrechnung*, an activity-based flexible product-costing system
- **UK:** the beyond budgeting movement

Tentative steps

Development of a new, proven best practice to create controlling, management accounting and analytical data supporting decision-making based on an IFRS performance concept is still in its early stages.

Most attempts to integrate IFRS-based financial accounting with management accounting do so only

at a very high aggregation level, usually at the segment or business unit level; that is, for aggregated actuals only. There are no analytical/management accounting concepts



JUERGEN DAUM

Juergen Daum is one of the initiators of the IMAS project, organising IMAS meetings on behalf of the International Group of Controlling (IGC).

He is the management and CFO adviser and chief solution architect at SAP (www.sap.com), and president and founder of the International Institute of Enterprise in Heidelberg, Germany

(www.iioe.eu), a think tank and training organisation that develops and promotes innovative concepts for enterprise management and entrepreneurship.

He regularly speaks at conferences and is the author of *Intangible Assets and Value Creation* (2003) and *Beyond Budgeting* (2005).

Management accounting and controlling organisations, academics and practitioners interested in joining the IMAS project initiative can email him at

jhd@juergendaum.com or visit www.juergendaum.com.

based on the IFRS performance philosophy to support management in detailed day-to-day decision-making.

This is creating a performance management black hole because operational managers do not have instruments to align their performance with IFRS-based targets. It also makes it impossible for financial accountants to provide sound and auditable fair value valuations, which require detailed, reliable and testable planning data.

Moving forward

It is clear that a new approach to management accounting is needed. One that supports decision-making and financial accounting, just like management accounting and cost accounting did in the old days. The time has come for international management accounting standards (IMAS).

Companies and the controller/management accounting community need to focus on advancing the controlling and management accounting systems to better support the external IFRS view, steer the business proactively and come up with the analytical foundation to support IFRS valuations that are reliable and meet the expectations of auditors and the investor community.

There are three important considerations that need to be taken into account: the effect of globalisation, entrenched, antiquated processes and the fact that management accounting cannot be standardised in the same way as financial accounting (see box, p 65).

The good news is that we do not have to start from scratch: many of the pieces required for a comprehensive redesign and redefinition of management accounting and controlling already exist; they just need consolidation.

Europe, in particular, has numerous well-tested and extensively developed management accounting and controlling concepts. Although they have only been developed and applied in a national context, there is

‘THERE ARE NO ANALYTICAL/ MANAGEMENT ACCOUNTING CONCEPTS BASED ON THE IFRS PERFORMANCE PHILOSOPHY TO SUPPORT MANAGEMENT IN DETAILED DAY-TO-DAY DECISION-MAKING.’

great potential to advance and shape the management accounting and controlling practice globally.

The International Group of Controlling (IGC) has proposed a cooperation initiative to address all European controlling and management accounting associations and interested (corporate) practitioners as well as academics – and with the support of the European Commission as far as possible.

Its mission is to develop IMAS in a holistic way by combining and consolidating the strengths of the different approaches and adding new concepts to fill any gaps. It also plans

to encourage non-European parties to join the initiative to bring it to an international level.

The process began with a first meeting in London in July 2006, which I organised on behalf of the IGC. A second meeting in November 2006 in Paris formally initiated the project and also set up a working group.

This cooperation initiative already comprises representatives from management accounting and controlling organisations from Denmark, France, Germany, the Netherlands, Poland, Spain, Switzerland and the UK, several academics from European universities and business schools, practitioners from European multinationals and representatives from the European Commission.

The hope is that we can come together to develop a truly rigorous

set of management accounting standards that can be applied internationally, allowing the entire finance community to move towards a system that is capable of dealing with the way business is done today and is transparent and understandable to all parties. **FDE**

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