

Management Accounting Research Group Conference

Thursday 14 April 2005

This year's Management Accounting Research Group Conference at the London School of Economics, with some 130 participants, the majority of whom were practitioners, was organised around the theme 'New frontiers in decision-making and in the public reporting of supplementary information.'

Overall, the five presentations centred on the role of non-financial performance measures in internal decision making and, significantly, in providing supplementary information on company performance to external stakeholders.

With the recent coming to force of the disclosure requirement 'Operating and Financial Review' in the UK (already compulsory for all listed companies), the conference was particularly topical.

Professor Michael Bromwich opened the conference, and welcomed all the participants. He flagged up one of the key messages of the conference: narrative disclosures (such as the OFR) are going to change management accounting in many organizations, and will inevitably alter the benchmarks of 'good management accounting' and 'good corporate governance'.

The first lecture was delivered by Professor Michael Shields (Broad Professor of Accounting, Michigan State University). He reviewed decision making research on management accounting with a particular emphasis on narrative reporting. Narrative accounting reports are becoming a noticeable feature on both sides of the Atlantic. However, there is only mixed evidence that narratives are associated with improved organizational performance. This raises the question whether narratives are sufficiently readable and comprehensible by users (including unsophisticated investors). Regulators and standard setters are stressing the importance of companies presenting supplementary information in a clear and understandable language. Professor Shields argued that research on linguistics and cognitive psychology can usefully inform practice as to the desirable qualities of narratives like OFR. Comments from the floor that followed the presentation highlighted the fact that analysts often have close knowledge of the firms and their industries that can render voluntary disclosures almost ceremonial. However, Professor Shields' line of thought accommodated the argument that narratives should be associated with readers' existing knowledge, implying that the OFR has to converge to what information is used by analysts. This animated discussion prepared the ground for Professor Bromwich's lecture on 'OFR and Intangibles'. After putting the OFR requirement in its historic context, he gave a lively interpretation of the regulatory text. He highlighted that the legal jargon will require meeting some serious reporting obligations that are being placed on firms. Particularly strong are the expectations that the scope of information should reflect the directors' view of the business and it should be revealed 'to the extent necessary'.

Given the mandatory nature of OFR and the duty it places on directors, Professor Bromwich predicts that it will provide a very important role for management accountants in the organisations concerned. They can, in effect, help a finance director to communicate to the investment community the fact that the firm's value is

higher than its net asset value. Indeed, there is some empirical evidence that analysts price a premium on the value of companies that do so. However, there are several implementation dilemmas that can be anticipated. In particular, directors will have to exercise a considerable amount of judgment concerning the relevance of non-financial information to investors. This raises questions about social and environmental information that can only be traced to valuations indirectly. Secondly, the validation of OFRs is likely to be a particularly contested area. Thirdly, there is an inherent tension between the broadbrush approach that the OFR requirement takes and the expected comprehensiveness of the information (about the enterprise, its business, industry and location) that that investors supposedly demand. Finally, Professor Bromwich highlighted a number of enforcement considerations, which, again, point to the role that management accountants might have in establishing clear audit trails as the time of 'sofa cabinets' is being drawn to a close.

After lunch David Viles, partner at Deloitte changed the focus from external reporting to the ways managers and accountants can conceptualise value drivers within the firm. In line with the principle that 'value is in the eye of the stakeholder', he started off by considering different types of stakeholders and the different categories of firm assets that they deploy. In particular, he demonstrated how one might prioritise value generating assets (such as brands, systems etc.) and value supporting assets (such as HR policies and equipment) according to their perceived importance to stakeholders. Prioritising these and linking them to particular stakeholders enables firms to develop a set of leading indicators that addresses the most salient (and highest priority) drivers of performance. The model was challenged from the floor by remarks about its complexity and the possible confusion it might induce. However, Mr Viles emphasised the inherent capacity of the approach to prioritise and to filter information according to the needs of top management and warned about the possibility of overkill.

Picking up this latter point, Juhani Vaivio (Professor of Management Accounting, Helsinki School of Economics) mounted a strong criticism of the increasing quantification that is taking place in organisations. He warned against the use of strategic non-financial measurement as a panacea to organisational problems. In particular, non-financial measures, by definition, can only capture the measurable aspects of performance, and they remain silent about a large part of strategic activity that is taking place beyond the scrutiny of measurement systems (e.g. CEOs lobbying regulators in order to actively shape their environments). Furthermore, the very definition of strategic measures is contested and often gets hijacked by managerial problems and trivial questions. Thirdly, in dynamic contexts where strategic measures need to change flexibly, there are only limited chances for any kind of 'measurement tradition' to take root. Finally, Professor Vaivio warned against the monolithic measurement bureaucracy that can stifle local grass-roots level organisational initiatives. At worst, the generation of more and more performance measures can be seen as a new form of Taylorism. It would be a dangerous avenue for today's organisations that are reliant on expert white collar workers. They can put up resistance and ultimately vote with their feet.

Finally, ICAEW Director Robert Hodgkinson delivered a presentation on the 'Information needs of markets and management.' He gave a stylised history of the new reporting models that now encompass not only the OFR, but also numerous

others (c.f. Jenkins report, Arthur Andersen's Value Dynamics in 2000, the Hermes principles etc.). The new reporting models constitute a fundamental change to the Divided Accounting model (where management accounting is seen as different to financial accounting). Instead of the traditional division between management accounting and financial accounting, the new reporting models aim for integration across shareholder reporting, financial reporting and sustainability reporting. The advocates of some of the new models make some very optimistic claims on what can be achieved via reporting. However, the ICAEW recognises the importance of continuing research and innovation in this area and hopes that practice will eventually rise above the traditional Divided Accounting model. Mr Hodgkinson therefore reiterated the ICAEW's commitment to a number of research themes that further a dialogue-based interaction between management-based information and external reporting. Mr Hodgkinson then spent a long time answering questions and comments. Following the formal aspects of the conference a buffet reception allowed participants to discuss the subjects raised during the day.

Professor Michael Bromwich and Dr Al Bhimani organized the conference with very good administration by Mary Comben. The long term sponsorship and support of CIMA and ICAEW is gratefully acknowledged.

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