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What's On?

October – November 2008, Toronto, Canada Strategic Cost Management and Strategic Business Analysis program Conducted by CMAGlobal. www.cmaglobal.com	November 2-9, 2008, Dubai, U.A.E. 3rd CMA Program on Strategic Cost Management and Strategic Business Analysis Conducted by the Wisdom Institute. www.cmadubai.com	December 2008, Kuala Lumpur, Malaysia 7th CMA Program on Strategic Cost Management and Strategic Business Analysis Conducted by Multi-Media College.	December 6 - 16 2008, Shanghai, China Proposed CMA Program, China March 8-15, 2009, Mumbai, India 11th CMA Program on Strategic Cost Management and Strategic Business Analysis Conducted by www.cmaindia.net

On Target
Newsletter of the Institute of Certified Management Accountants
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JAMAR Editors Win Prestigious International Management Accounting Research Award!

Professor Janek Ratnatunga (Co-Editor of the ICMA's JAMAR) and Professor Kashi. Balachandran (Consulting Editor of the ICMA's JAMAR), have just won the American Accounting Association's Impact on Management Accounting Practice Award. This is the most prestigious award in management accounting research worldwide, and is sponsored by the Management Accounting Section (MAS) of the American Accounting Association, the AICPA-USA, CIMA-UK, and CMA-Canada.

The award is given annually to a paper published within the last five years in a refereed academic journal that has the greatest potential impact on Management Accounting Practice.

The paper, authored by Janek Ratnatunga, Norman Gray and Kashi Balachandran, titled, "CEVITA: The Valuation and Reporting of Strategic Capabilities" was published in the CIMA research journal, Management Accounting Research (Vol. 15, No.1, pages 77-105) in March 2004, and deals with the "new types of measurements" that are needed for both tradable and non-tradable assets in order for organisations to meet the challenges present at the corporate, national and international levels, especially in the areas of strategic decision-making and valuation.

The paper states that the focus of attention in recent studies has been mainly on the valuation of intangibles. This paper argues that such a focus misses the point that it is the combination of both tangible and intangible assets that provide an organisation a true 'capability' that ultimately drives its economic value. The paper then reports on a research study conducted to value organisational capabilities for a Strategic Military Unit, that developed a reporting framework comprising of a Strategic Balanced Sheet and Strategic Income Statement; and then extends the framework to the commercial sector. The approach is basically to calculate the Capability Economic Value of Intangible and Tangible Assets (CEVITA) of an organisation, by leveraging its capability enhancing expenses to economic values by using specific Expense Leveraged Value Indexes (ELVIs). This paper illustrates a technique that will not only make these strategic valuations more relevant, but also shows how to report these tangible and intangible asset combinations in an organisation's financial statements. The paper finally argues that even if generally accepted accounting principles cannot accommodate such value-creating information for external reporting,

the gold standard

the management accounting profession needs to develop them for internal reporting that is less constrained.

The lead author of the paper, Professor Janek Ratnatunga, MBA, PhD (Bradford), Dip.Mkt, FCA, CPA, CMA, holds the Chair in Business Accounting in the Department of Accounting and Finance at Monash University, Australia. He has also held academic positions at the University of Melbourne and the University of Canberra in Australia; and the Universities of Washington, Richmond and Rhode Island in the USA. He has authored/co-authored twenty-five books on strategic cost management, entrepreneurship, financial accounting, accounting theory and professional modelling; and over 200 academic and professional papers. He has worked in the profession as a Chartered Accountant with KPMG, and is currently a consultant for the World Bank. He has undertaken a major consultancy for the Australian Department of Defence in the valuation of strategic capabilities, and has valued the 'brand' capabilities of major Japanese IT companies worldwide. He is also a world authority on the business and accounting implications of global warming and carbon trading.

Professor Kashi. Balachandran, BA (Madras), MS, PhD, CMA (University of California, Berkeley) is Professor of Accounting and Operations Management at New York University Stern School of Business. He teaches courses in management accounting, management control systems and financial accounting
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Professor Balachandran joined Stern in 1979. His primary areas of research include optimal operation of service systems, incentive contracts and mechanisms, transfer pricing determinations, conceptualization of unused capacities and their optimal utilization, warranty contracts, quality enhancement programs and reporting, activity based costing systems business measurement systems and optimal performance evaluations. Professor Balachandran has written and published more than 65 articles in leading academic journals of economics, accounting and management science. He is the editor-in-chief of the Journal of Accounting Auditing and Finance. In addition to serving on the editorial boards of several journals, he has refereed for numerous journals and research funding agencies.

The third author of the paper, Air Vice-Marshal Norman Gray was the Head of the Airborne Early Warning and Control Division of the Defence Materiel Organisation, within the Department of Defence in Australia. He is now retired.

The ICMA congratulates the authors on this magnificent recognition of their work in management accounting practice.

Carbon Financial Statement Accounting

Snapshot Series!

From the discussion in the previous issues of On Target, it can be seen that interesting Financial Accounting issues also arise in the area of trading in carbon credits. This mainly depends on if an allowance or carbon credit is:

- granted free to a business entity by a government,
- purchased in an auction run by a government,
- purchased in a free-market, or
- created by a company allowed by a State Authority to issue them.

The main issue revolves around the issue if the requirements of the Kyoto Protocol give rise to an asset (carbon sink) or a liability (carbon source). If the government rations CO2 emissions via a 'cap and trade' allowance scheme, then that allowance will have a monetary value and the following questions will follow: Is the 'allowance' an asset? If a separate asset is recognized, what is the nature of that asset? Is there 'income' when the allowance is received, or is income deferred until the allowance is traded? If income is recognised, how is it measured? Is the potential penalty, which will be incurred if a participant fails to deliver sufficient allowances to cover its actual emissions, be recognised as a contingent liability, and how should it be measured? These and other questions will be discussed in this section.

It is generally agreed that a 'carbon allowance' is an intangible asset. However, it is a new category of intangible asset, i.e. one that should be measured at fair value with changes in value recognised in profit or loss. Note that i intangible assets arise due to a third party transaction such as a purchase of a carbon allowance, then it can meet the accounting profession's reliability test. However, carbon credits created internally by carbon sinks cannot be recognised until they are sold in open trading. An inconvenient truth is that the profession has great difficulty in internally generated intangible assets such as brand values and intellectual property, and it is still coming to terms with reporting issues arising due to carbon trading.

The inconvenient truth is that companies to date have very little guidance from accounting and assurance standard setters as to the treatment of carbon related intangible assets. For example, depending on the business, it could be argued that this category of intangible assets can be accounted in three ways: as items of inventory if the organisation is set up to trade in 'allowances'; as financial assets and measuring them at fair value with gains and losses recognised in income, and as derivatives by accounting for them as a cash flow hedge.

At present, the position of the financial accounting profession is by no means clear. However, considering all views and alternative treatments, the current thinking of the financial accounting profession appears to be that a carbon emissions trading scheme give rise to at least three treatments:

- A government grant (when allowances are allocated by governments for less than fair value) (debit: intangible asset; credit: revenue). Questions as to if such revenue is taxable or exempt from tax will be based on a specific country's tax policy. This government grant is measured at cost when received from the government. The grant of allowances is recognised in income on a systematic basis over the compliance period.
- An asset for allowances held. (Debit: intangible asset; credit: equity reserves) at fair value. The fair value would be based on market values if a trading scheme exists.
- A liability for the obligation to deliver allowances equal to emissions that have been made (debit: expense; credit: liability) at fair value, and ultimately purchasing in an open market 'carbon credits' equal to the shortfall (debit: liability; credit: cash) at market value.

Most approaches treat carbon assets (i.e. allowances) independently to the liabilities (i.e., obligations), and accordingly, netting off (i.e., offsetting) of the assets and liabilities is not likely to be permitted. Thus carbon allowances/liabilities could represent a significant figure and thus have an impact on the "bottom line" volatility of a company's reported financial statements.

This perceived (artificial) volatility in the income statement is a major concern for CFOs, as they have to record a gain in the value of emission rights to equity, but the loss related to revaluing the liability as a profit or loss item. Current, GAAP and Accounting standards are of no help to them. Management accountants, on the other hand, are not constrained by GAAP, accounting standards and assurance requirements in reporting and information provision. Research into issues such as carbon pricing, whole-of-life costing, carbon efficiency management and product-distance evaluations, would perhaps be avenues by which the accounting profession can play its part in help reducing global warming.

This ends the snapshot series on the business and accounting impacts of Global Warming.

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Those members who did not pay their annual membership subscription fees by 30th September 2008 will now be delisted. If you have simply forgotten, please forward your 2008-2009 subscription to the Institute before 31st December 2008 and you will be reinstated without the payment of penalty fees. Thank you.

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Graduate (GMA)	**$165.00**	**CMA**	**$209.00**

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