Editorial

Empowerment Accounting: The Role of Financial Statements in the Shift from the Informational to the Influential Paradigm

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Abstract

The paper argues that the rapid changes and the intensity of competition in the global economy make new types of measurements necessary for national competitiveness and economic progress. The accounting profession needs to identify what those measurements will be, devise ways to capture the required information and report them reliably to interested parties. They must then link those measurements to the organisation's rewards system. Finally, they must train the employee category of interested parties to understand the reports and be motivated by them. This requires research into what the subject-matter of accounting should be within an "informational-era" global economic paradigm, and how to extend and disseminate this subject-matter across the entire organisation in order to influence and empower its employees. This need to have measures that have a 'motivational' impact is seen as the emerging 'influential' economic era.

Key Words

Empowerment Accounting
Open Book Management
Strategic Balance Sheet
Strategic Audits
Economic Paradigms

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Introduction

A bloke was in a hot-air balloon when he drifted into heavy fog and lost his bearings. He dropped down a bit and spotted the ground. A chap was watching his descent. "Can you tell me where I am?" the balloonist shouted. "Yes," came the reply. "You are about 50 metres up in the air in a balloon." "You must be an accountant" the aviator yelled. "How did you know?" the ground-based bloke asked. The balloonist replied: "Because the information you've just given me, while being completely accurate, is totally useless."
(Anon)

CPA Australia gave gold to the company James Hardie Industries in the *Australasian Reporting Awards*, and then found the company embroiled in allegations that it has been a serial liar in those reports. CPA Australia's public affairs manager, Jennifer Simon, in defending the award, said that it was for "how" reports are constructed rather than "what" is actually reported (Gettler, 2004).

Ms. Simon, inadvertently, or not, was not merely making a case in defence of an award granting process that turned into a public relations nightmare, but in reality she was making a statement that all thinking accountants know is true, i.e. that financial accounting reports place *form* over *substance*. Thus, as long as the form as per the accounting standards of the day is followed, the substance (or accuracy) of what was being reported did not matter.

One of the greatest academics Australia has produced is the late Professor Ray Chambers. He was also a past president of CPA Australia. In CPA Australia's own journal he noted the following:

....The accountants endorsed or invented rules that yielded values which had no counterparts in commercial reality at balance sheet dates - sheer fictions, such as valuation at the lower cost and market, LIFO, FIFO, straight line and crooked line depreciation, and all kinds of arbitrary allocations. And they invented a doctrine of their own - the historical cost doctrine, which justified the use in dated financial statements of wildly out-

of-date facts without disclosing their dates.

The only semblance of up-to-date facts that appeared in balance sheets were then amounts of cash and debts owed and owing. They added this miscellany of fictions, and out-of-date and up-to-date facts, and held that the result gave a true and fair view of the states of affairs of companies at stated balance sheet dates. ***And they still do***. [Chambers, July 1991, Australian Accountant]

CPA Australia, as in the case of their recent James Hardie embarrassment, is not alone in being unable to separate fact from fiction in financial reports. Enron, the most spectacular collapse in the recent past, also won many awards for its financial reporting (Hill, 2002). Consider for example the following extract from an Australian newspaper.

The entire accounting profession, especially auditors, has been asked by the media to explain how a set of company accounts can be signed as "true and fair" one year, only to be similarly signed a year later with $1.7 billion of shareholders' funds gone.

When was the above explanation sought? By an Australian financial journalist as far back as in 1990! At that time, Australia had just seen a number of spectacular instances in which such a shareholder fund meltdown had happened, for example, in such diverse organisations such as Rothwells (Merchant Bank); National Safety Council (Service); and Elders IXL (Conglomerate). According to media reports at that time, the auditor's defence in most cases has been to disclaim responsibility for false accounts and to point the finger at directors.

This led Kohler (1990) to state in the media that the auditors have got their defensive routine down pat.... "It's not our fault. Directors have the primary responsibility to shareholders. How can we help if they decide to start economising with the truth?"

Such excuses are not satisfactory said Kohler at the time, "Auditors have a job to do, which is to check whether company accounts are 'true and fair'. If the accounts later turn out to be untrue, then the auditors have some talking to do even if it was the directors who lied."

Corporate bankruptcy increased to an all time high in Australia during the early 90s (Webb, et. al 1991). During this period, media reports regarding myopic auditors were almost as numerous as those regarding deceitful directors. What was the accounting profession's response at that time? Increased regulation, increased compliance, increased accounting standards! That should fix the problem it promised (Tweedie, 1991). No more spectacular collapses, promise! Then came Enron, WorldCom, Ansett and OneTel. Collapses in all parts of the world 10 years later. What was the accounting profession's response this time? Oh yes, increased regulation, increased compliance, increased accounting standards! But this time with a twist, what we need, the profession now claims, is "convergence", i.e. international accounting standards (IAS) that apply across every country. That should fix it! No more spectacular collapses, promise!

This paper argues that, no matter how much the profession tinkers with its reporting model with a patchwork of accounting standards, it can no longer be relevant to today's needs, and therefore auditing such a model to obtain a 'true and fair' opinion is an exercise in futility. It will then argue that changes in the world economic order may result in accountants going the way of the "dodo", if they do not adapt to the new environment. The paper finally traces new approaches to performance reporting in keeping with today's economic paradigms.

Globalisation and Empowerment: a Twin Paradigm Shift for the Accounting Profession

Globalisation is the first new paradigm shift impacting the accounting profession. The profession must look upon such global changes as "opportunities" in providing value-creating information, as there is growing evidence that the changes in the global economy require new types of "measurements" for meeting the challenges at the corporate, national and international levels. In this sense, a response to *Globalisation* has been the drive by the

accounting profession for "convergence", i.e. international accounting standards (IAS) applied across all countries. Such moves have not only got the seal of approval by the profession, but also legislators and governments, all of whom are pouring millions of dollars into convergence projects. Incredibly, however, none of the recent spectacular collapses took place due to differing accounting standards in different parts of the world. Unlike the world of taxation, where companies can organise themselves to take advantage of differing tax regulation in different parts of the world, Enron, for example, did not collapse due to making use of differing accounting reporting standards amongst its many subsidiaries around the world. It collapsed because it found a reporting area that was not addressed by their home country standard or any other standard in the world! Thus, even if we were to get convergence, which will eventually be a combination of the USA based Financial Accounting Standards Board (FASB) standards and the London based International Accounting Standards Board (IASB) standards, this does not guarantee that sometime in the future some company will not find another unaddressed area and take advantage of it. As long as we have unethical lawyers and accountants who carefully study the prevailing accounting standards of the time for loopholes, and a transactions based accounting model which uses widely out-of-date facts (as per Chambers, 1991) , spectacular future collapses are inevitable.

What is required therefore is not a model that is patched every time it leaks, but a new model for a new age. The auditing profession should be clamouring for such a new model, as currently they are asked to give a 'true and fair' opinion with regards to a faulty valuation model.

The second new paradigm shift is the move towards *Empowerment*, whereby employees are seemingly motivated by providing them a means of participation in the strategic process by giving them access to information streams, in terms of financial and other performance based indicators. Where globalisation is forcing financial managers to look outside their organisations to meet the competition coming from far-horizons, empowerment is requiring them to delve deeply within their organisations in order to motivate their employees to meet the competitive challenges of globalisation.

This paper considers these twin-paradigm shifts, and first considers and identifies those "new types of measurements" required in a globalised environment, and devises ways in which to calculate and report them reliably. The paper then looks at "empowerment accounting" and shows how organisations can create and evaluate a balanced strategic ownership culture in a globalised environment, and account for such changes in ownership using the new measurements devised within the first paradigm.

Forces Affecting the Current Accounting Paradigm

As illustrated in Figure One, the current accounting paradigm is a *remnant* of the needs of an industrial-era enterprise - where the "brains" were provided by white-collar workers; the "brawn" was provided by the blue-collar workers; and the "capital" was provided by investors and other parties external to the enterprise. The role of accounting was to enable the "brains" to monitor and control the "brawn" (i.e. the area of management accounting); and to report on the success of such controls to the providers of the "capital" (i.e. the area of financial accounting). *[See Ratnatunga, 2002 for a detailed discussion of Figure One]*

Increasingly, the providers of "capital" require far more information than past performance - they are becoming far more preoccupied with the future safety and performance of their investments. Further, governments (infrastructure); employees (human assets) and environmental groups (the Earth) are also claiming to be providers of capital. This requires the provision of:

- Strategic and control information;
- Future-orientated and historical information;
- Financial and non-financial information;
- Profit-motivated and socially-responsible information;

- Timely and accurate information; and
- Motivational information

Ratnatunga (2002) states that whilst the profession grapples with these problems, the last 20 years has seen the emergence and rapid growth of the ***informational - economy.*** As illustrated in Figure One, the "fuel" of this era has been *education*. The "economic engine" has been the communication of *knowledge*; hence the need for information technology (IT) coupled with telecommunications (e.g. the internet, e-commerce, B2B etc.).

In an informational-era enterprise, the distinctions between white and blue-collar workers are far less pronounced, as all workers become *knowledge workers* (see Figure One). The role of an accountant (or other informational professional) is to manipulate the available data and provide the information in terms of the new measures demanded by these knowledge workers.

Consideration should be given to the *nature, recognition, and measurement* of information-era assets. The engine(s) that drive information-era enterprises include knowledge, innovation, communication, learning, and innovative abilities. However, such assets are still systematically excluded from our industrial-era balance sheets; thus understating the total "capital" of the enterprise. Therefore, currently "short-term monetary capital maintenance" is the focus instead of "long-term comprehensive capital maintenance". This also provides temptation to managers to reduce some of these assets for the sake of short-term earnings.

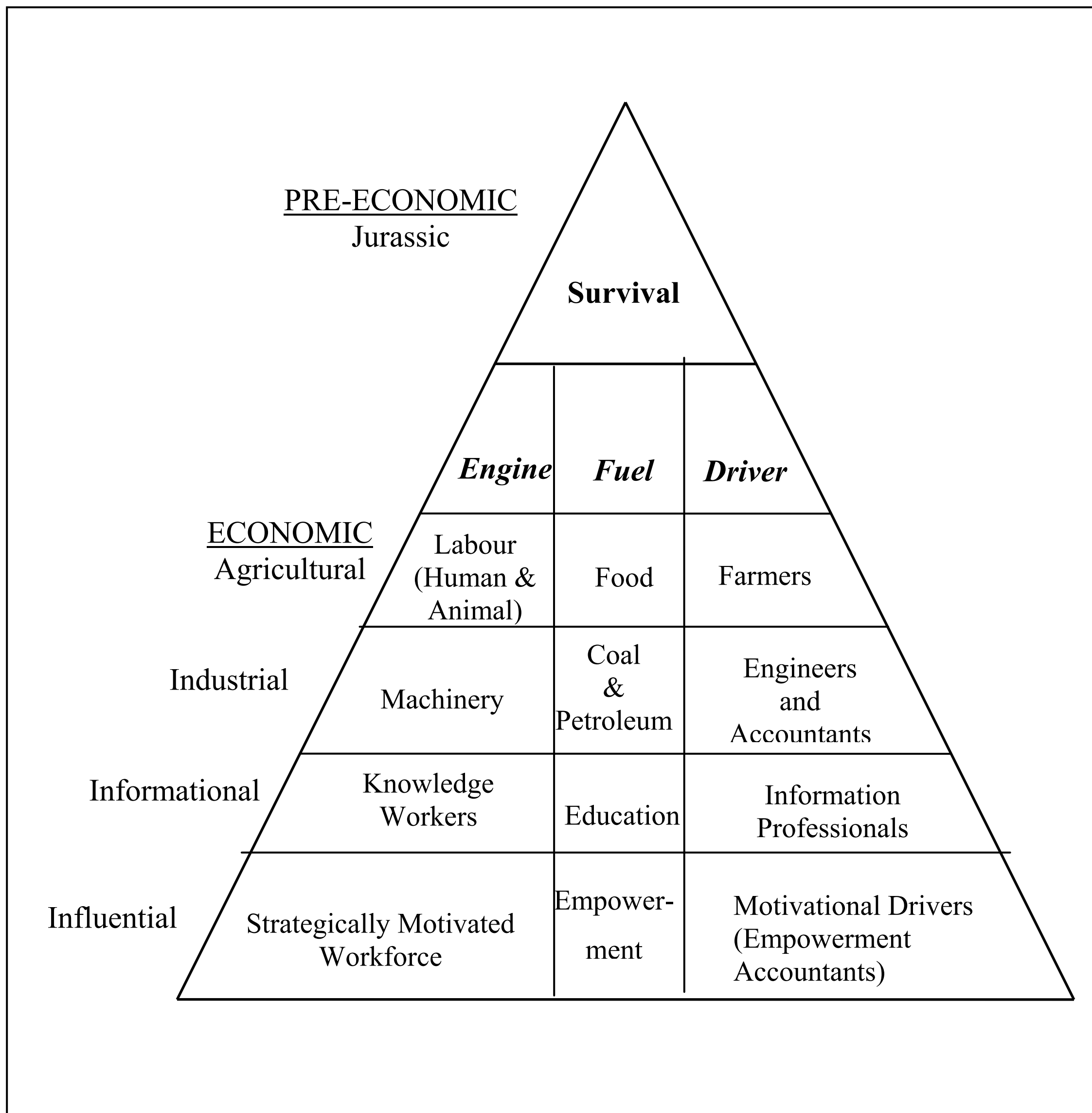
The provision of accounting information must keep pace with the *timing* requirements of information-era enterprises. Information technology (i.e. computers and telecommunications) is speeding all functions and turning them into virtually continuous processes. Management needs *process measures* in "real-time", not event measures after the event. The frequency and freshness of measurements must be related to how fast environmental change is occurring in the process/enterprise being managed. The current interest in "One-day Reporting" is an indication of the importance of this area.

Information stability assumptions should be rethought. In an unstable environment, one cannot expect measurement systems to remain stable. The KPIs themselves need to be regularly monitored to ensure information usefulness in a changing global environment. Measures must report not only rates of activity, but rates of change in rates of activity.

The above are merely indicative of the areas that need to be considered in order to broaden the subject-matter of accounting and in order to increase its *relevance* to information-era decision makers. There is no fundamental reason why the accounting profession cannot become the *information professionals* of the information-economic era. A case has been made for the need of a new paradigm in accounting properly directed research and education should bring it about.

Ratnatunga (2002) states that even as the accounting profession is trying to grapple with the new measures required by the *informational* economy, a new economic paradigm has emerged, i.e. the ***influential economy***, which argues that whatever new measures derived should ultimately *motivate* the economic engines of this economy; i.e. a strategically motivated workforce (see Figure One). Empowering the workforce is seen as the fuel that will enable this engine to be efficiently and effectively driven, giving them a strategic ownership culture. *And the driver?* Many professions will vie for this role, such as industrial psychologists, human resource professionals and organisational behaviour experts. However, it is ultimately it is how the workforce performs in meeting *quantifiable* organisational objectives, and the *rewards* they receive for good performance, that will drive their motivation to align themselves to an organisation's strategy. Thus the "motivational drivers" will come from within the ranks of the information professionals, and accountants could have a major part to play in this emerging economic paradigm.

Figure One: The Changing Economic Paradigms



Source: Ratnatunga, 2002.

Accounting Challenge No. 1: the Need for a New I*nformation* R*eporting* Paradigm

There is growing anecdotal and empirical evidence that our current Industrial-era accounting paradigm is becoming increasingly ***irrelevant*** within the economic paradigm of the information era.

This has resulted in the number of accountants who rise to the top of their organisations significantly diminishing in numbers in comparison to previous years. Other corporate management positions are being compensated at levels higher than that for accountants. Accounting and accountants are becoming increasingly under attack for tax frauds; corporate collapses; transfer pricing jugglery; de-stabilising nations; and polluting the environment!

The most compelling evidence pertaining to the decline of the conventional-accounting role comes, however, from the behaviour of the then Big-Five (now Big-4) Chartered Accounting firms. During the last decade every one of them has stopped describing themselves in their promotional material as "C*hartered Accountants*". Further, one of the professional bodies in Australia, the *Australian Society of Certified Practising*

Accountants has had a name change, calling itself, simply, *CPA Australia.* The reference to being an *accounting* body has been completely downplayed. It has even changed the name of its professional journal from "Australian Accountant" to "In the Black", whatever that is supposed to connotate.

Such evidence, even from within the accounting profession, strongly indicates that our industrial-era accounting paradigm is *retarding the profession,* especially with the need for new measurements demanded by organisation facing increasing global competition.

The age of the corporation (since 1850) led to the enormous emphasis on the determination of profit - hence the acceptance of arbitrary cost allocations. Now the focus has widened. Owners, investors, creditors, bankers, government now all need *leading indicators*. Accounting - especially financial accounting - is still preoccupied by *lagging indicators*. For example:

- Historical records
- Financial statements (including cash flow statements)
- Ratio analysis
- Auditing
- Variance analysis.

Such a preoccupation with the past is akin to *"navigating by looking at the wake created by the ship"***.** This is only possible, if one is sure one is going in the right direction, and if one is sure there will be no unexpected ships, icebergs and floating debris crossing the ship's path.

One significant area in which the traditional financial accounting measurement model fails is in the area of ***intangibles***. Take for example the much-quoted case of Microsoft, whose total assets were, in the year 2000, 7.5% of market value; and its physical assets were less than 4% of the book value of total assets (and only 0.3% of market value) (Leadbeater, 2000).

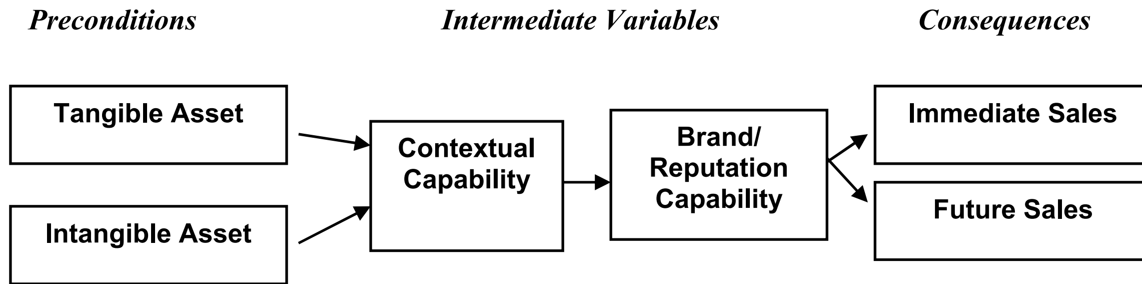
Thus if we are to develop a new accounting model for a new age, we need new types of "measurements", for both tangible and intangible assets in order for organisations to meet the challenges present at the corporate, national and international levels, especially in the areas of decision-making, performance evaluation and organisational valuation. If the financial accounting profession cannot provide value-creating information to such leaders and managers, we need to develop them in managerial accounting that is less constrained by the standard setting profession.

The problems associated with implementing these new measurements are immense. For example, in the marketing communications area, even if tangible assets (such as the sales force, billboards, trade promotions counters, samples, catalogues, etc) and intangible assets (brands, logos, trade marks, advertising jingles, slogans, patents and copyrights)[1] can be valued, what is especially difficult in practice is the valuation of the associated *tacit knowledge* and *judgment* required to combine these differing assets to enhance the capability (and ultimately value) of the organisation.

Figure Two illustrates the issues involved. The available tangible and intangible assets are the *preconditions* required for the inducement of sales (the *consequences*). These preconditions act via an *intermediate variables* of contextual capability and brand capability (or organisational reputation) to generate both present and future sales potential. The present value of such sales potential is therefore the "value" of the contextual capability that gives rise to the brand/reputation capability.

[1] The definition of an asset used in this paper, is that of a cost incurred which has a "future economic benefit". Current financial accounting reporting standards will not recognise some of these costs as assets, such as the costs of maintaining a well-trained and motivated sales force and much of advertising costs. Many of such costs are considered has having only single period economic benefits, and thus are expensed in financial accounting reports. However, Ratnatunga et al. (2004) argue that such costs enhance the strategic capability of an organisation and thus should be considered as capability assets for future oriented decision-making.

Figure Two: Preconditions and Consequences of Capabilities



At this point it is important to contrast *tangible* and *intangible* assets, *contextual capability*, *brand (reputation) capability* and the resultant *capability value*. Assets are "what one has", much like a Ferrari racing car (tangible asset) or Michael Schumacher's driving skills (intangible asset). Contextual Capability is what can be achieved in a particular situation (or "what one can do") when these asset categories are combined in a contextual situation, i.e., win the World Championship. Brand/Reputation Capability is the esteem perception created in potential customers' minds about the Ferrari brand as a consequence of winning the world championship. Capability Value is the economic value of the capability (i.e. the current and future monetary value to Ferrari via sales, having a Brand Reputation of winning the formula one championship).

Ratnatunga et al (2004) argue that in terms of Defence capabilities, this contextual capability variable is particularly relevant. For example, youth may be particularly relevant for ground troops, but in terms of fighter pilots the amount of flying time (experience) is the key-indicator that determines capability. Thus, whilst promotion of more senior people to managerial tasks in the Army's may increase the strike capability of its ground troops, similar promotions may reduce the strike capability of the Air Force.

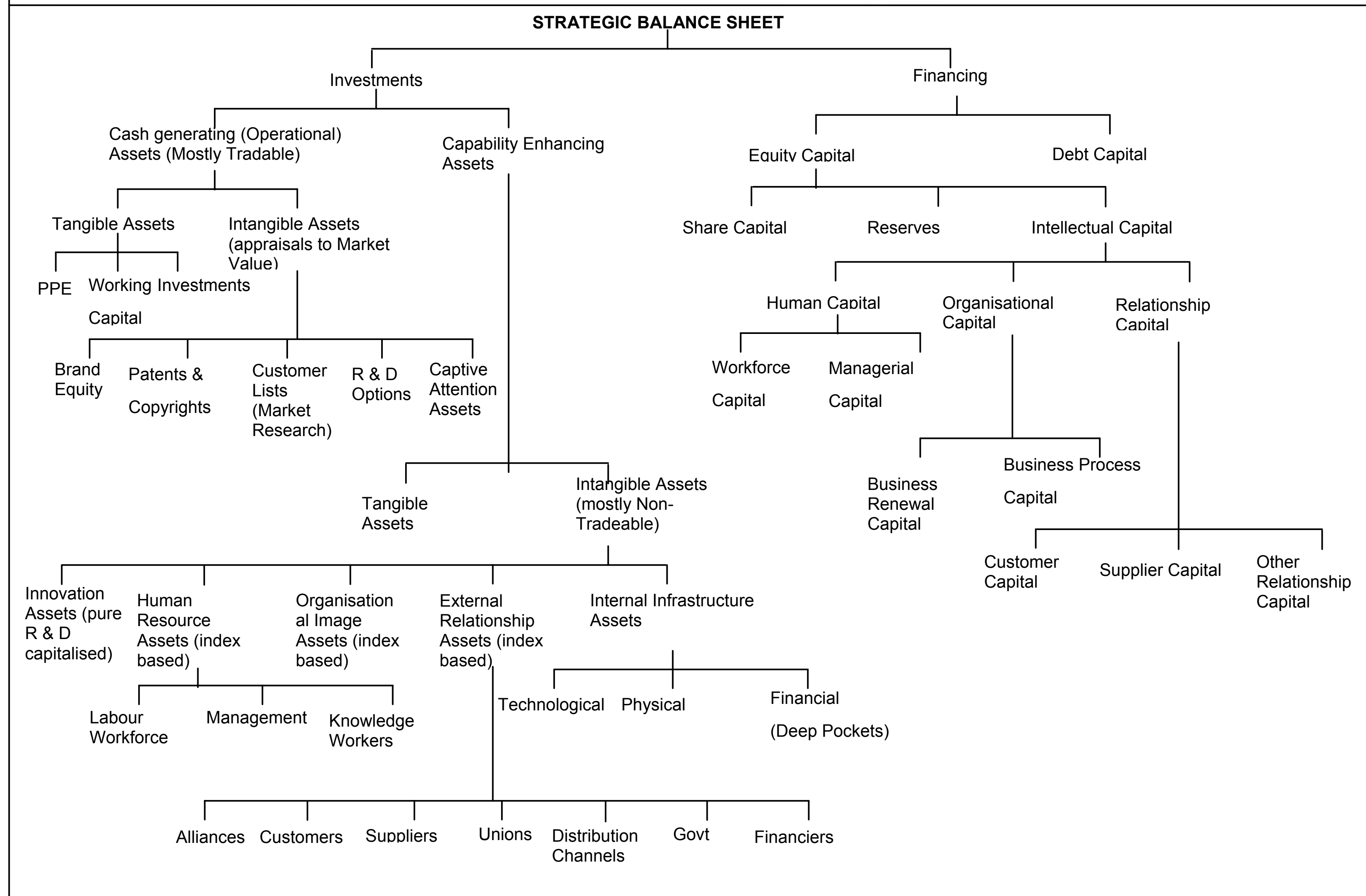
It is clear that in implementing current GAAP, financial professionals face a dilemma when it comes to valuing intangibles. This is because they want financial statements to be both *reliable* and *relevant*. Reliability is easy to achieve, but relevance is not. This is especially true when it comes to knowledge-based organisations such as Microsoft, because the intangible assets are not referenced in their statements, yet these assets are highly relevant to its stakeholders.

The Accounting Profession believes that financial statements must be 'reliable', i.e. they must be both accurate and supportable. Such reliability would suggest that if two different accountants prepared the same statements, the two answers should come close to each other, particularly if they each relied on the same hard evidence. This is why the profession has worked hard over the last 30 years to issue 'Accounting Standards' to ensure that as much subjectivity as possible is removed in their preparation, and why it is now working hard towards the convergence of these standards. Unfortunately the result is that we have financial statements that report a company having a book value only 5% of the value the market places on it, as in the Microsoft case.

Accounting standards achieve 'reliability' by requiring evidence of an arms-length transaction between two parties. Thus when an organisation buys an asset, such as a truck, from an external supplier, and cash changes hands, this is good evidence that the organisation now has an asset that exists (and in most cases can be physically verified, thus increasing reliability) and that a sale has been made by the supplier company, and thus a profit (or loss) can be recognised by it.

Despite the GAAP in most countries recognising that the purpose of financial statements is to also provide investors and creditors with information about future

Figure Three: The Strategic Balance Sheet in a Commercial Organisation



earnings prospects and cash flows (i.e. be relevant) in the case of intangible assets, because an 'arms length' transaction has not occurred (and thus their valuation fails the 'reliability' test), these are kept off the balance sheet, or the amounts paid in creating them are expensed. Thus if IBM was to buy Microsoft, as then there would have been an arms-length transaction between two parties, the 95% unrecorded value of the latter company would magically be reported as an asset called 'goodwill'.

However, as argued before, intangible assets are equally as relevant to an understanding of the organisation's strategic objectives. Ratnatunga et al (2004) proposes a valuation method to convert all such strategic expenses to assets values, and also the double-entry recording process to record such capability values in financial statements. The ultimate result is a Strategic Balance Sheet as illustrated in Figure Three incorporating both tangible and intangible asset capability values.

There will be many hurdles to climb before the accounting profession can be comfortable with such proposed a new model. Also, there may be other proposed models. Whist at this stage it is unclear as to what model is ultimately chosen, what is important to realise is that the current transactions based model is no longer relevant in the information age.

One suggested short-term compromise is to make the ***'cash flow statement'*** the principal financial statement. This is the thrust of the Chambers (1991) quote given earlier. This is because, whist 'cash values' are not the same as 'capability values', of the current statements, the cash flow statement has the lowest possibilities of being subjected to manipulation.

"Profit is an opinion; cash is fact" (Anon)

The traditional accrual based profit and loss statement and balance sheet, and the strategic balance sheet proposed in this paper, can then be subsidiary statements.

Ratnatunga et al (2004) states that the organisation they studied considered three approaches as suggested by Leadbeater (2000) to integrate the above measures in organisational reports to stakeholders as follows:

The Fully Integrated Approach: The approach here takes the view that the traditional financial accounts will remain the focal point of organisational reporting for some time, and therefore it is appropriate that the new measures detailed above are incorporated in these statements to help investors derive values based on contextual capabilities. This approach would require 'market consensus valuations' based on non-financial measures that are relevant, relatively easy to collect and have a proven relationship to capability value.

The Supplementary Approach: Here separate Strategic Financial Statements are prepared, to sit alongside the traditional statements prepared as per GAAP. These will incorporate traditional financial information as a measure of success and as a resource for investment, but the focus mainly will be on measuring the capability enhancing tangible and intangible asset combinations, and the corresponding capability value.

The Hybrid Approach: This is a compromise approach where the incorporation of tangible and intangible capability asset values is a gradual process. The Hybrid approach is designed to allow organisations gradually to combine traditional and novel ways of valuing asset capabilities. It would permit them to deal more effectively with volatility and uncertainty by providing half-way-houses and revisable rolling accounts. Industry standards for disclosing relevant non-financial information about contextual capabilities would allow more robust links to be made between investment in intangibles and market valuations, if appropriate. Traditional financial accounts would become more relevant and responsive by becoming more flexible and adjustable to suit specific circumstances.

The concept of *half-way-houses* is when the organisation 'quarantines' its contextual capability values before allowing them to migrate to the balance sheet. Tangible and

intangible asset combinations are valued as capability assets without putting them on the actual balance sheet until their value is more established. This would allow the organisation to adopt a more flexible approach by stating possible ranges for capability asset values.

A similar concept is that of the *revisable rolling accounts*. For example, it might not be wise to capitalise the R&D of a high-risk new technology based capabilities at an early stage of development because the future benefits would be so uncertain. However, at some point, when the technology and the market have become less volatile, capitalisation may become more realistic. It might then be worth restating past accounts to show how they would have looked if the R&D had been capitalised. The justification for this approach is that the accounts are the financial history of a company and like most histories they should be revised in the light of new information.

Whatever approach to implementation that is adopted, it will be necessary to initially estimate the current capability value of all tangible and intangible assets in an organisation, and have an *'Opening Strategic Balance Sheet as at a particular date'* after which the double-entry accounting approach outlined in Ratnatunga et al (2004) could be carried out.

Once a new, and relevant, model of accounting information and valuation is introduced, the next development stage of the profession is to train those who are going to 'certify' the veracity of the information. Such training would, of necessity, be more comprehensive (especially in terms of business analysis), than that required to give an opinion on the traditional financial statements.

Subramaniam and Ratnatunga (2003) state that strategic information reports should be developed to link long-term or strategic goals of an organisation with performance evaluation outcomes, and therefore that appropriate strategic audit techniques would also be required.

A *Strategic Audit* is far different from the common perception of financial audits. It is a continuous evaluation of all the strategic functions of any success-seeking firm. Due to such a wide scope, strategic audit issues are pertinent to management accountants, business analysts, audit directors, senior managers and executive-level management, as well as those aspiring to become someone who oversees audit, security, compliance and control functions.

Strategic Audits should not only dwell on highly technical matters, but also provide management and other stakeholders a perspective on information systems and technology issues at the strategic level. This will in turn promote good corporate governance by enabling managers to make well-informed planning and resource decisions that will ultimately enhance the value of the organisation.

Accounting Challenge No. 2: The Need for a New *Information Influencing* Paradigm

A significant amount of research exists on the differences between the "Western" and "Japanese" management control systems. It has been argued that whilst the Western management control systems have "truth and accuracy" as their reporting objectives, the Japanese control reports are designed to elicit "behaviour changes" of managers and employees, sometimes at the expense of accuracy. Both approaches have significant downsides. The Western approach often results in information understanding with very little behaviour modification by managers and employees. In contrast, the Japanese systems obtain behaviour modification, but very little information understanding.

The *influential-era economic paradigm* takes the view that employee behaviour can be modified in the long-run only by creating a holistic global ownership culture where behaviour is changed due to understanding the strategic impact of the information that is presented to such an employee. This is achieved only by ensuring that all participants know the "rules" of the game, know how the "score"

is kept, and ultimately participate passionately in the “game” that is being played.

In most companies, employees are likened to the poor American who comes to Australia to watch a game of “cricket”. He or she is a participant in the overall atmosphere of the game, but his or her own enjoyment and motivation to keep watching is significantly reduced by not knowing the rules, what strategies the teams are employing, how to keep the score, or for that matter, who is winning!

Transferring this analogy to an organisation, if employees do not know what are the organisation’s strategies are, or the measures used to evaluate good and bad performance, then they would have no idea if the organisation they belong to is doing well or not. Consequently, they will not be motivated to work towards the goal of organisational success. The key aspects of this open-book approach are that it:

- shares a broad array of financial and other information with employees,
- trains employees to become more business literate,
- empowers them to use the information in their work, trusting them as partners, and
- rewards them when the company is successful.

One can see that accounting plays a vital role in the implementation of such an open-book policy, as most corporate performance measurements are ultimately accounting-numbers based. Measures such as profit, return on investment (ROI), earnings per share (EPS), and the price-earnings ratio (P/E), are all derived from the financial accounting statements. If rank-and-file employees are provided these numbers, then they would need to understand and interpret these measures. Thus, training employees first in accounting (i.e. the language of business), and subsequently in other scorecards incorporating non-financials, becomes an important part of open-book management.

It has now been seen, however, that financial and non-financial information *on its own* will not motivate such knowledge workers to strive to achieve the strategic objectives of the organisation in a globalised environment. In the emerging ‘influential-economic’ paradigm, the role of accounting is to *empower* these knowledge workers - i.e., train them to have knowledge understanding and then provide them with all the necessary information to steer their organisations successfully in the globally competitive waters.

Empowerment accounting using an open-book policy is, therefore, essentially not only teaching employees how to read organisational scorecards and enabling them to judge if their team is winning or not, but to be provided with all of the information (financial or otherwise) and responsibility required to be a team player in the game of business.

Jan Carlzon, the President of the Scandinavian Airline System, summarises this approach excellently in his book ‘Moments of Truth’ as follows:

- Everyone needs to know and feel that he (or she) is needed.
- Everyone wants to be treated as an individual.
- Giving someone the freedom to take responsibility releases resources that would otherwise remain concealed.
- An individual without information cannot take responsibility; an individual who is given responsibility cannot help but take responsibility (Carlzon, 1989).

The proper implementation of empowered open-book management requires, therefore, something more than training employees how to interpret financial and other scorecards. It requires a fundamental change in the traditional way in which managers operate their business; i.e. by providing both information and responsibility for employees to *think and act like owners*. Essentially, such managers are committed to *empowering* their subordinates to use the information provided, and act like the owner of their niche in the organisation.

Employees will act as owners, only if they share the organisation’s goals, and are

rewarded when these goals are achieved and the company is considered successful.

The inescapable logic of open-book empowerment accounting is, therefore, that employees are likely to share organisational goals when they:

- Understand how an organisation's assets combine to provide a capability to create value;
- Understand the techniques used to measure how much value was created;
- Are provided regularly the scorecards that show how value was enhanced (or lost);
- Are empowered to act in a manner that will improve the value-creating capability of the organisation; and
- Share in the rewards when the organisation does well.

If measures are meant not only to 'inform' but also influence, then the *accountability* focus of accountants should also be widened. In the industrial-era, accountability was to owners, creditors and managers. In the *informational*-era, customers, suppliers, government and environmental groups, among others, increasingly demanded enterprises to be accountable (via various economic and political lobbying powers). In the emerging *influential*-era, employees are also demanding to be part of the ownership culture with full participation in implementing the objectives and strategies of the enterprise.

Research is therefore required to develop measurements, in order to discharge all potentially significant accountabilities. Multiple measurement-units and reporting formats need to be developed to cater for the conflicting accountability demands of different internal and external constituencies. This will require both *leading* and *lagging* measurements as discussed earlier, and all of the varied informational categories presented in Figure Four.

Empowerment Accounting – The Methodology

Once the measurement issue is considered and relevant indicators are derived, the empowerment accountant needs to turn his or her attention to the need for disseminating those key measures critical to the success of a particular organisation to its employees, and to motivate the employees to act upon those measures in line with its strategy. However, some of the controversial issues that have arisen due to such an open-book policy are as follows:

- Sharing sensitive information with employees is risky;
- They may demand more remuneration;
- Competitors may get hold of the information;
- Employees cannot fully comprehend the big picture;
- Training employees to understand financial reports is not easy;
- Not all performance and rewards are measured in financial terms.

In a comprehensive research study undertaken in the USA by the *Financial Executives Research Foundation (FERF)*[2], seven companies were investigated in-depth. It was found that, in general, the risk element of information leaking to competitors was largely unfounded. It was found in the study, however, that the seven companies had varying degrees of "openness". For example, and not surprisingly, the information most frequently withheld was individual salary information for rank-and-file employees. All seven companies, however, regularly disclosed detailed operating data to employees and placed particular emphasis on numbers that affected incentive compensation. However, disclosure did not mean that employees received their own printed copies of reports or had continuous access to information. Thus "real" open-

[2] Barton, T.L., Shenkir, W.G. and Tyson, T.M., "Open-Book Management: Creating and Ownership Culture, Financial Executives Research Foundation Executive Report, Vol. 5, No.2, March 1998

book management obviously required broad – but not total – information sharing.

In terms of employees requiring training in understanding financial reports in order to fully comprehend the "big picture", the above quoted study found that the companies in the study group varied in their approach to training. Some companies found that formal training courses worked the best, whilst others preferred to incorporate training informally into the daily activities of open-book management.

The last of the controversial issues is the observation that 'non-financial indicators' are playing a growing role in the measurement and evaluation of performance against strategic goals. Many employee incentive schemes are being based on such measures. This issue leads us to look beyond open-book management and take a "balanced" view of the organisation, and simultaneously train employees to understand both financial and non-financial measures. This will:

- Empower them to monitor and control the organisation's activities in a manner measurable against its strategy and objectives;
- Contribute to the strategic decision making process;
- See how they would be rewarded for the successful implementation of strategy.

One of the most commonly used methodologies for developing the information set and rewards system against the above three factors is:

"To match rewards to the critical success factors of the business".

The critical success factors of a business are 'the limited number of areas in which results, if they are satisfactory, will ensure successful competitive performance'. The most common factors cited by executives as being crucial to the success of their business are:

- Cost structure;
- Product quality and innovation;
- Customer satisfaction;
- Management development;
- Change management and flexibility.

However, research undertaken in many countries indicates that most Chief Financial Officers (CFOs) concentrate and provide only in-depth information on the first of the above critical success factors, i.e. on the firm's *cost-structure*, or in other words provide only critical financial information. Further, such financial numbers are most often reporting past information. This is the reason why companies implementing open-book management philosophies concentrate so heavily on financial indicators, they are the only ones available!

		Internal		External	
		Past	**Future**	**Past**	**Future**
Financial	**Numeric**	Financial Reporting	Budgets and forecasts	Competitor's results	Broker's forecasts
	Text	Results narrative	5-year plan framework	Brokers review	Press opinion
Non-Financial	**Numeric**	Operating performance	Capacity planning	Market share	Market research
	Text	Performance commentary	Strategic goals	Trade media coverage	Technology forecasts

Figure Four: Framework of Leading and Lagging Indicators

Empowerment accounting extends the philosophies of an open-book style of management into the non-financial arena, in order to empower employees into taking a holistic approach in creating an "ownership culture". If it is expected that employees take crucial decisions that affect the company in a "moment of truth", then they should be made aware of not only the financial impact of their decisions but also the non-financial, i.e. the overall picture. In order to provide such information, organisations must provide both past and future oriented information, both financial and non-financial information, and both numeric and textual information, and also train their employees on analysing and interpreting such information.

The following Figure Four indicates the information depth required under *empowerment accounting.*

Implications for the Chief Financial Officer (CFO)

Because sharing financial information is key to empowerment accounting, the CFO must also champion these open-book management approaches. However, this support may require a change in the traditional parameters of the CFO's position.

At the outset, the development of an open-book empowerment culture will obviously rely heavily on the financial talents of the CFO, and willing cooperation of the CEO. The CFO is the "gatekeeper" – the key financial expert in the company who maintains the store of information upon which open-book management and empowerment accounting largely draws. CFOs who try to preserve a "business as usual" attitude in an open-book culture will severely restrict the potential of the system in the following ways:

- They will not be actively involved in explaining the implications of the open-book financial and non-financial numbers.
- They will consciously or unconsciously resist disclosing information regarding the critical success factors or key performance indicators (KPIs) of the business.
- They may believe that empowering employees is detrimental to the company (fearing that information might be leaked outside the company, for example) and intentionally subvert its smooth functioning.

There was strong support in the seven companies studied by the FERF for the notion that CFOs must possess the following skills or attributes if they are to positively contribute to an open-book culture:

- The ability to motivate others (one CEO in the USA calls it "cheerleading") – to enable a "buy-in" of the open-book culture throughout the company and to ensure the continued commitment of all to sustain it into the future.
- The ability to train others on how the business makes money and on what the financial and non-financial information means.
- The ability to adapt – to understand their role in the new culture and to execute it professionally and enthusiastically.
- The ability to communicate effectively – to speak in everyday language and avoid unnecessary jargon or technical lingo, and to enunciate clearly the goals and strategies of the company.
- The ability to set aside prejudices and irrational fears – to avoid a traditionalist mentality and ensure that the open-book empowerment culture will be given the chance to succeed.

Summary

The strategic use of information technology has caused significant changes in business; however, the accounting profession remains committed to a by-gone industrial-era of the economic development paradigms. For example, there should be no controversy within the field of accounting and financial reporting that issuers of financial statement should provide the readers of financial statements with all material information that is both relevant and reliable. The

relevance of both tangible and intangible assets has not usually been questioned, but the reliability of valuations of such assets has often been questioned.

The profession can remain committed to fine-tuning the debits and credits of this by-gone era; or work closely with technical departments of professional firms and university accounting faculties, to research on how accountants could provide decision support information in competitive environments. This change is paradigm is essential in a global sense, if accountants are to regain their role as one of the key drivers of the knowledge engine in an information-age economy.

We have argued that an organisation should measure value beyond its financial performance, and help managers integrate processes and resources into the organisation's overall success—an essential step toward competing in a knowledge-based environment. Just as traditional accounting tools helped managers accumulate and allocate an organisation's financial resources, a new conceptual framework is required for managing its capabilities, including its intellectual capital.

The impact of intellectual capital measurement is a fast-growing part of the knowledge management market. It has many attractions, at least in theory. The process of drawing up a Strategic Balance Sheet focuses managers on the capabilities enhanced by such intellectual capital. It also helps managers and investors to visualise the role of intangible assets in creating organisational value. These new measurement systems all use similar measures of human capital, customer relationships and structural capital, for example in the latter case, those embedded in organisational relationships and joint-ventures.

Once such new measures and reports are devised, there arises the need to audit them. However, auditors face a multiplicity of demands from diverse users of audited accounting reports. These demands appear to keep extending the role of the auditor. In order to ensure that a claim for damages is not made by any or all of the multiple-users of audited financial statements, auditors try to conduct an extensive audit in order to fulfil all such perceived duties and responsibilities. Despite this, large claims have been made against auditor by liquidators; due to the belief that auditors have "deep pockets".

This paper highlights the importance of future oriented strategic auditing and how the various types of strategic audits have implications for attesting the strategic capability values of the organisation as a going concern.

Finally, it is argued that knowledge and information is of no economic value unless it is used to *create value*. In today's globalised business environments such value is created by knowledge-worker employees working in a shared ownership culture who understand the information that is presented to them and are motivated by this understanding. There is no doubt a CFO must be up to the task of championing the new culture. The CFOs in the companies that have implemented the changes demanded by this emerging "influential-economic era" have found the work fulfilling and exhilarating. To a large degree, the open-book empowerment culture is flourishing at their companies because of their efforts and commitment.

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