The Institute of Chartered Accountants in England & Wales

Faculty of Finance and Management

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Finding the best ABC sites on the web

This selection of web sites may be useful for readers wishing to follow up the activity based costing feature (see page 3).

Using Activity Based Costing to Manage More Effectively – a report published by PricewaterhouseCoopers in the US as part of their research grant awards. Although focused on the value of activity based costing for decision-making in public sector universities in the US this study provides a clearly set-out study of activity based costing that has wider applicability.
www.endowment.pwcglobal.com/pdfs/GranofReport.pdf

ABC Guidebook: A Guidebook for Using and Understanding Activity Based Costing – a US guidebook on activity based costing, originally produced for internal use but widely read for its look at the industry-wide principles of ABC.
www.c3i.osd.mil/bpr/bprcd/0201.htm

Implementing Activity Based Costing – comprehensive practice and technique guide from the Institute of Management Accountants in the States defining ABC, and laying out the practical issues from setting out the process of design and information gathering, through to ensuring the success of your ABC system.
www.imanet.org/content/Publications_and_Research/Statements_on_Management_Accounting/imabc.htm

Consortium for Advanced Manufacturing – International – web site of the consortium that introduced the concept of activity based costing including a selection of news articles and columns on developments in ABC.
www.cam-i.org

More links on ABC and many other subjects are available from the award-winning ICAEW web site's links pages at: www.icaew.co.uk/library

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Comments and suggestions should be addressed to Chris Jackson BA FCA, Head of the Faculty (see left).

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FACULTY OF FINANCE AND MANAGEMENT

Formal notice of date of AGM and Faculty lecture

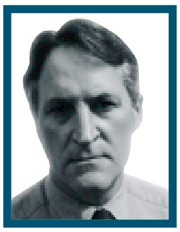
Tuesday 28th May • 12.30pm
Chartered Accountants' Hall, London

A Faculty lecture on Directors' Remuneration will be given by Ruth Bender of Cranfield School of Management on the same day as the Faculty's annual general meeting (AGM). The proceedings will start at 12.30pm and will be followed, approximately one hour later, by a buffet lunch.

This event is free to all Faculty members, and is not open to non-members.

How ABC helps marketers find value

Accountants and marketers have not seen eye to eye in the past. However, the marketers are beginning to talk a new language – that of value based marketing – and this may provide for a better relationship in the future, says **Richard Barrett** of the Armstrong Laing Group. Activity based costing (ABC) is one way to achieve that.



It's always been part of business mythology that marketers and accountants are like oil and water and according to a study reported by Tim Ambler of the London Business School in his recent book, 'Marketing and the Bottom Line', they are still far from seeing eye to eye. When asked which business function they see as necessary for long term growth, only 57% of finance directors chose marketing, leaving it fifth behind information technology (92%), training (86%), human resources (79%) and research and development (59%).

It could be argued that the way in which marketing functions think and communicate with the rest of the enterprise leads to this view, preferring to talk about 'softer' issues such as brand equity, and consumer awareness instead of 'harder' issues such as return on capital employed and shareholder value. But one would think that marketers were fundamental to success in today's demanding business environment; the very storm troopers of the modern business world. Marketers themselves certainly think so.

Below is one of the newer definitions of marketing set out by Professor Peter Doyle of Warwick University in his seminal book, 'Value Based Marketing', published last year. Such a definition should warm the heart of many a finance director as it surely reflects their view of what marketing ought to be about: "Marketing is the management process that seeks to maximise returns to the shareholder by developing and implementing strategies to build relationships of trust with high value customers and to create sustainable advantage".

Profitability management

Such a definition implies that marketers know what will actually create long-term shareholder value. When I have asked this question of senior marketers, their usual responses are to do with generating profitable sales and increasing margins. But if you probe a bit further, few have actually got a firm grasp on which of their customers, products and distribution channels are truly profitable and which actually destroy value. Despite being obsessed with measuring the effectiveness of campaigns and the cost of customer acquisition, few marketers – or, indeed, others in the organisation – have asked the fundamental questions that management struggles to answer, namely:

- which of my customers are truly profitable and where do I find more of them?
- which of my products are truly profitable? and
- are my channels of distribution earning their keep?

Whilst most organisations have a firm grasp on their direct costs, many are realising that they can only answer these types of questions through activity based costing (ABC) and its application in management – activity based management (ABM).

Furthermore there is a realisation that ABC is an essential part of the decision support tools needed to underpin a value based strategy in any area of the business, be it product range, strategy or deploying a meaningful customer relationship management (CRM) programme.

Despite its having been around for the best part of 20 years, there are few companies that have wholeheartedly embraced ABC/M and rolled it out across the business as a decision support tool. Typically, companies have dabbled, keeping ABC/M initiatives firmly within finance. But after a decade of deploying ERP and CRM systems, many of which still have to show a return, many people believe the time is right to revisit ABC/M.

Indeed, in June 2001 business analysts AMR Research said that "ABM is rapidly changing from a staid, annual manufacturing-oriented process into an essential real-time decision component used to assess profitability for new products, channels, and customers. With all the talk of revenue optimisation, ABM has been ignored as the other half of profit optimisation."

Shattering some long held beliefs

Where ABC/M has been used to underpin marketing decisions, the results can be transformational. Typically absorption costing leads us to believe that all products, customers and channels are profitable to some degree. However, this view is highly distorted as some costs are unfairly loaded whilst others are understated. Profitability analysis undertaken using ABC results in a very different picture due to the more appropriate and realistic apportionment of costs using activity drivers.

Typically we now find that some products and customers are unprofitable, possibly shattering some of our long held beliefs. There have been countless cases where an organisation's 'most favoured' customers or products have been found to yield little or no profit or even to be heavy loss-makers.

What were once considered to be 'cash cows' are shown to be 'dogs' and vice versa. Using this approach, companies have rationalised their product portfolios. Unilever is famed for reducing its global product range by many hundreds of brands – and is reported to be repeating the exercise.

Warner Lambert also used ABC/M to help rationalise its product portfolio, eliminating 50 unprofitable lines across 20 brands – while both sales and profits increased.

IFAC names 2001 winner

The Financial Management Accounting Committee (FMAC) of the New York-based International Federation of Accountants (IFAC) has announced the winners of its 2001 Articles of Merit Competition.The overall winner is Regina Herzlinger for her article 'The Outsiders', which focuses on managerial accountants in non-profit and governmental organisations.

The article was nominated by the Chartered Institute of Management Accountants (CIMA) in the UK. This article is included with nine other articles in the on-line and printed booklet 'Articles of Merit – 2001 Competition', including one by Faculty member John Fanning. The other award-winning articles focus on budgeting, customer relationship marketing, the balanced scorecard, environmental costing, and enterprise resource planning systems.

The printed booklet with all articles may be purchased for $25 plus shipping and handling and can be ordered through the IFAC's on-line bookstore, (www.ifac.org/store). **The electronic version may be downloaded free of charge**.

Customer relationship management – poor payback?

In recent years, CRM has become one of the latest management 'holy grails' with hundreds of blue chip organisations pursuing the goal. However, recent bulletins from business analysts such as the Butler Group, suggest that disillusionment is beginning to set in with few companies able to identify a positive payback from their investment in CRM systems. To understand why this has occurred we need to go back to basics.

The aim of CRM is to enable organisations to maximise customer profitability by efficiently and cost effectively acquiring profitable long-term new business – ultimately delivering higher shareholder value. The starting point for CRM is a clear segmentation of the customer base, a thorough understanding of the needs of each segment and a nimble organisation that can configure its resources to meet those needs. However without the insight that ABC can bring, things can easily go awry. The business sets out to do all the obvious things such as cross sell more products and improve customer retention

But no-one has bothered to investigate the true end-to-end profitability of the different products that are being cross sold or the customer segments who are being targeted. Revenues increase, but so too do the operational costs so ultimately there is little positive impact on the bottom line.

Had ABC/M been used to provide the marketers with an insight at the start, they might have been able to target customer segments where the anticipated costs of service are low relative to the gross margins that may be earned. Such was the case with a number of the regional electricity utilities following the deregulation of the electricity supply market. Maintaining or improving margins in this environment was not about simply going for growth, but about targeting and retaining the most profitable customers, where the costs involved in providing service are lowest.

Here ABC/M was used to cost internal service processes such as processing payments, collecting late payments, processing changes of address, acquiring new customers and so on – as well as examining the degree of perceived added value in these processes. The criteria defining the most profitable customer segments included those where such customers:

- had relatively high consumption (higher revenues);
- were standard tariff users (higher revenues and lower maintenance cost);
- paid by direct debit (low cost of collection and no debt chasing);
- moved house infrequently (no opening/closing meter reads or account changes);
- had stable, predictable demand (accurate bill estimation meaning minimal re-billing); and
- were aware and intelligent buyers (minimal phone contact).

These criteria were then matched to consumer types using commercially available lifestyle profiling in order to identify the demographics of the key target segments. Similar approaches are now being used in the banking and financial services sectors which encounter many of the same types of problems – hard to differentiate products and increasingly clued-up consumers.

Although the adoption of ABC/M still has a way to spread and still tends to be corralled by the management accountants, it is possible to identify companies that use activity analysis to support strategic decision-making from the outside. They tend to make bold moves well before anyone else in their market and generally steal a march on their competitors.

However benefiting from the insight that ABC/M brings, their strategies are far from risky. Not only have they a firm grasp on what is driving cost in their business today, they are able to model the future costs associated with their bold new strategies. It is this that gives them the confidence to make such moves whilst everyone else watches in awe. My guess is that in these companies, finance and marketing really are working hand in hand to bring about value based marketing.

Richard Barrett, MBA, FCIM is vice president of worldwide marketing in the Armstrong Laing Group.

PROFILE

Merchant banker to finance director

Newly co-opted Faculty committee member **Christopher Pearce** is a one-time chairman of the 100 Group of Finance Directors, was finance director of Rentokil for the 13 years to 2001, and before that spent 17 years in corporate finance. Helen Fearnley reports.

Recently retired as group finance director of Rentokil Initial after 13 years (readers may recall the company's spectacular almost uninterrupted record of some 20% annual growth in share price and profits during that period), Christopher Pearce brings a wealth of experience in corporate management and finance to the Faculty committee.

Prior to this substantial period in industry, Pearce spent 17 years in merchant banking, mainly with Schroders, concentrating on corporate finance. Before that he qualified with a small accountancy firm before moving to the much larger Cooper Brothers (later to become Coopers & Lybrand and now PwC). He has also been chairman of the 100 Group of Finance Directors (1997 to 1999) representing the interests of the FTSE100 companies, served on the Rutteman committee, which prepared guidance on internal controls for the original Cadbury Code on corporate governance, and has been a member of the Chancellor's Business Advisory Group on the implications of the euro.

Hence Pearce has looked at finance in business from many different angles during the course of his career. He is particularly aware that the information and skills requirements of businesses change as the environment changes. He is full of praise for the Faculty of Finance and Management's track record to date, observing that: "The fact that some 10,000 Institute members are prepared to pay an additional subscription to attend the Faculty's events and receive its literature is very impressive and indicates that it is doing the right things for its target membership."

However, he goes on, "It is important to continue to listen to what the members want and ensure that we deliver it. The business environment has changed enormously in recent years and continues to change both with new technology and with increasing regulation. This increasing regulation – for example new corporate governance codes and accounting and reporting standards, or UK government and European Union initiatives on health and safety, human resources, and human rights – is increasing the formality in running a business, making it more structured and increasing the administrative burden. We need to continue to provide guidance to members in these areas as well as in financial and general management."

Education

Pearce's motivation for studying accountancy was to gain a business education. As he says, "At that time it was the best way to achieve a business grounding, and still remains one of the best." His five years training with a small firm (now disappeared) provided a broad range of experience, working with clients who could be anything from a public company to a sole trader.

In 1965, feeling the need for experience in a larger, more structured firm, handling bigger businesses, he joined Coopers. The first couple of years there were spent on audit but he then moved on to investigations, including looking at anything from companies preparing to go public to those about to go bankrupt. He also worked on new rules for government contract pricing (still in use today). While with Coopers he spent a period working in New York at the (then) affiliated firm of Lybrand, Ross Bros and Montgomery.

On returning to the UK in 1970, Pearce moved away from auditing and into corporate finance, joining the merchant bank Schroders and staying for the next 14 years working on bond issues, takeover deals and general financial advice. Clients included the likes of ICI and Land Securities. His stay there included a two-year stint in Hong Kong (1972-1974) working mainly on public flotations, during which time the Hang Seng went from 350 to 1750 and then down to 150. It was, he says "an interesting experience of a 'bubble' bull market inevitably turning to 'bust'". He also spent two years in Brazil running Schroders' foreign currency banking and local money market operations.

Deals

In 1984 he moved to County NatWest but this move coincided with the change in 'tone' within the City, when merchant banks began to emphasise bringing in deals rather than giving advice to clients and many of those working in investment banking were young enough never to have experienced anything but a bull market and thought that shares only ever went up.

Pearce felt it was time to move to the corporate side and, with good timing, he joined Rentokil as finance director in September 1987 just weeks before the meltdown of Black Monday. The rest is more or less history. Working closely with Sir Clive Thompson, "an excellent chief executive" he was closely involved in the period of phenomenal growth, both organic and through acquisition. There were of the order of 300 acquisitions, ranging from the huge £2 billion purchase of BET to more modest ones. More recently, there were disposals and a share buy-back of 28% of the equity. Profits grew from £37 million in 1987 to £540 million in 1999. Not surprisingly, Pearce deems it "an exciting and enjoyable time".

Although he retired in January 2001, he retains non-executive directorships – as chairman of the audit committee for Debenhams plc, and as a Rentokil Initial Pension Trustee.

Pearce – a man who has been at the front line of finance for several decades – is now keen that others similarly involved in the cut and thrust should continue to be well-served by the Faculty. As he puts it "The Faculty is doing an excellent job. It is important to continue to keep in touch with the members, find out what they want going forward and keep delivering this to them."

Budgeting: survey finds the weak spots

In the first quarter of 2001, a team from the Centre for Business Performance at Cranfield School of Management and Accenture's Finance & Performance Management Service Line undertook a "substantial review of worldwide planning and budgeting practices". The goals were to establish what are considered as best practice in planning and budgeting and to identify evidence of improving shareholder returns with enhanced planning and budgeting.

The research team reviewed some 100 academic and practitioner books and papers and completed face-to-face interviews with executives from 15 different firms, including ABB, Bank of Scotland, Belron, Borealis, BP, Cisco Systems, Credit Lyonnais, DHL, Electrolux, Ford SAS, Shell, Skandia, Svenska Handelsbanken and Volvo. These interviews were supplemented by discussions with more than 30 senior analysts from six leading investment banks. The study also built on earlier research by Accenture and Charles Schwab, which explored the planning and budgeting practices in 28 companies.

The survey concluded that significant weaknesses exist in the traditional approaches to planning and budgeting, which are widely criticised.

This research identifies the 12 main criticisms of traditional budgeting as:

- budgets are time-consuming and costly to put together;
- budgets constrain responsiveness and flexibility and are often a barrier to change;
- budgets are rarely strategically focused and are often contradictory;
- budgets add little value, especially given the time required to prepare them;
- budgets concentrate on cost reduction and not on value creation;
- budgets strengthen vertical command and control;
- budgets do not reflect the emerging network structures that organisations are adopting;
- budgets encourage 'gaming' and perverse behaviours;
- budgets are developed and updated too infrequently, usually annually;
- budgets are based on unsupported assumptions and guesswork;
- budgets reinforce departmental barriers rather than encourage knowledge sharing; and
- budgets make people feel under-valued.

Strategy: time for action

In this third in a series of articles on strategy, **Chris Hughes-Rees** reviews the strategic steps of gap analysis, critical success factors, strategy implementation plans and the linked issue of annual business plans and project planning.

The two previous articles on the subject of strategy (*Finance & Management*, issues 71 and 75) discussed the initial stages of vision, stakeholder drivers, portfolio analysis and moved ahead into the actual formulation of the strategic direction, segmentation, plotting relevant time horizons and, finally, risk analysis. Now we move on.

Gap analysis

To move forward from today to where we want the business to be at various future time horizons requires a clear understanding of the 'gaps' between the two. Driving the business forward is primarily achieved by managing these gaps. The analysis of the gaps will form the platform for developing the next steps in the strategic process: determining critical success factors and the strategy implementation plan.

During this analysis step, it is important to look closely and thoroughly at the requirements for moving ahead. Attempting to move directly from the strategy goals to the development of the next annual business plan without thorough analysis would probably mean misunderstanding and mis-aligning some key deliverables.

Returning to the 'Situation Analysis' step, and considering the move to the following step of 'Strategy Segments and Time Horizons', it is clear that no effort was dedicated to looking at this 'now versus future' gap. Hence the challenge, now, of figuring out what it will take to get there.

Critical success factors

Critical success factors (CSFs) are quite simply those actions or deliverables that must happen (and when) if we are to fulfil our strategic goals. Without correctly understanding and establishing these CSFs, we are lost. They should be key elements of the strategic goals as defined by the segment analysis and horizon defining and may be described by some as 'strategic enablers'. Within your strategy segments there are perhaps only a handful, even in a global business. Consider the following examples:

- you are a global organisation and the organic growth rate of the business will clearly not satisfy one of your strategic goals or vision. You decide that to plug a gap and steal a competitive march on time you need to acquire a competitor. This would be a CSF, as it is clearly a 'big ticket' item that must happen; or
- you need to develop rapidly an e-business capability yet your IT platform and e-business 'know how' is very patchy. This is a major issue that must be addressed before the e-business opportunity can be grasped. This would be a CSF.

There is a clear difference between a CSF and an action plan item. CSFs should flow through to the action plan stage and a (potentially substantial) number of actions will be required to ensure that the CSF gets delivered. A CSF is at the high level and achieving it must happen. The allocation of responsibility for the action plan deliverables (discussed

FIGURE 1 IMPLEMENTATION PLAN AND ENABLERS

Design plan framework by segment

Define deliverables

Determine timing

Assign leadership responsibility

Assign actions to business units

Assign actions to business unit teams

Building blocks

Strategy segments

CSFs

Gap analysis

MEETS SHAREHOLDER/STAKEHOLDER DRIVERS AND HORIZONS

MEETS VISION AND HORIZONS

Validation

Challenge sessions

Re-structure if required

FIGURE 2 ANNUAL BUSINESS AND PROJECT PLANS

Define framework

Segment implementation plan and enablers

Define deliverables

Determine timing within plan

Assign leadership responsibility

Assign actions to business units

Assign actions to business unit teams

ALLOCATE IMPLEMENTATION PLANS AND ENABLERS ACROSS MULTIYEAR PLANS

Validation

Challenge sessions

Re-structure if required

later) should link back to responsibility for each CSF. Obviously there should be a logical balance and link of responsibilities to capture efficiency and ensure clear alignment with the subsequent reward systems.

Implementation plan and enablers

Implementation requires a clear and complete plan, specifically stating what needs to be done, clear accountability for implementing all the component parts, clear deliverables with timelines and also direct links to the reward systems.

The strategy implementation plan in my view is rather more part of the initial setting of the strategy deliverables than is the annual business or project planning cycle. I refer to project planning as some organisations look more at the project streams rather than the annual business plan. If both are operated, then clearly some care must be taken to ensure that accountability is free of confusion and there is not a clash of measurement points that can distort deliverables.

Arguably, it depends on the nature of the business but I would suggest that a combination of the two can often be appropriate, provided that the two approaches neatly inter-link and do not distort the business drivers or create a mis-alignment somewhere along the strategy process.

The strategy implementation plan is not therefore the annual business plan but is the platform for creating the annual business and project plans. I view the overall implementation plan as something that is 'real time' logically moving in tandem with the strategic process itself whereas the annual business and project plans have set intervals for delivery which may well be considerably shorter, depending upon the nature of the business.

The organisation must initially understand the longer term strategy implementation plan and not just focus upon the annual business plan and project plans. Additionally, the process and intervals for updating plans must also be clear. A major strength of this approach is that the rolling strategy implementation plan, coupled with the rolling strategic process, enables a higher quality and more focused annual business plan and project plan structure.

Moving to the 'enablers' of the implementation plan, ie those items that must exist as a platform for the plan to move ahead, I see these as mainly threefold – leadership, funding and people resources. The point here is that the leadership structure and capability must be in place, otherwise there is little chance of success. The leaders of the organisation will take collective (and individual) responsibility for delivering strategy via the planning mechanisms.

Secondly, the issue of funding, or rather, the allocation of the scarce cash resource. This will initially take place in outline when we undertake the portfolio planning process. But now we have moved ahead into detailed planning, we must loop back from this planning point to the earlier portfolio process to ensure that we not only support our planning requirements but keep our cash needs aligned with the overall cash (and consequently other) profiles.

Thirdly, there is the issue of people resource. Collectively, the business must look at the resource content items of talent, capability and experience and ensure that the right mix of these content items exists and this also lines up with the timing requirement. The action plan cannot succeed without the availability of the right people resource.

Annual business plan/project plans

At this stage, we are aware of the strategic process and consequent strategy implementation plans that will drive the organisation forward to achieve our strategic goals. But the initial 'full cycle' implementation plans are not conveniently aligned or segmented into annual business plans and project plans.

This whole process may provide a valuable opportunity to re-visit how annual business planning is conducted, together with the project planning process. It may result in a significant shift in how the business is managed – maybe a skew towards a project based organisation that can often be easier to manage within the portfolio analysis process.

Ultimately, whether you believe that your organisation is best suited to a traditional annual cycle, one that is project based or a combination of the two, the key is to keep re-assessing this balance over time.

(The fourth in this series of articles will deal with strategy alignment, measurement, reward systems and communication.)

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MARKETING **UPDATE**

The pros and cons of advertising in a recession

In his latest Update column **Alan Mitchell** discusses the tricky problem of whether to advertise, or economise, during a recession.

Alan Mitchell writes extensively on marketing and finance, and is a former editor of Marketing magazine.

Should companies maintain their adspends during economic downturns? Over the past few months, a chorus of advertising and media voices has rushed to shout 'Yes!'. With dotcom dénouement, telecoms traumas and the aftermath of September 11, you can understand why. Even so, it's not a particularly helpful response.

The arguments for and against are familiar enough. Cutting adspend is an easy to way to massage a sagging bottom line. On the other hand continued investment in the brand can send strong signals of management confidence to analysts and investors. Also, once a brand does lose momentum it's doubly expensive to get it back up to speed, and aggression during recessions can pay handsomely – you get much greater share of voice at lower cost.

There is a clear pattern, according to Professor Paddy Barwise, chairman of London Business School's Future Media Research programme. Barwise, author of 'Advertising in a recession', notes that: "The 'sheep', who maintain marketing investment through thick and thin, increase market share during the slowdown and significantly outperform the 'goats' (who don't) during the recovery."

Vociferous

Even so, it is rather disturbing how the advertising industry has emerged as a highly organised and vociferous lobbying group. Are they lobbying for their own interests or for those of the businesses that pay them? Additionally, the blanket terms of this debate – whether or not advertising is a 'good' thing – obscure more than they enlighten. Is surgery 'a good thing'? Not if you are trying to treat influenza.

The critical issue, as Barwise stresses, is each brand's 'unique context'. Every company needs a robust model of its brands' particular market dynamics, including cyclical characteristics. For the likes of Dell, Wal-Mart, Ryan Air and Easy Jet, consumer and corporate belt-tightening is as much an opportunity as a threat. British Airways and the US car manufacturers, on the other hand, have faced falling off a cliff. In a desperate attempt to move metal and sell seats, they've been throwing promotional incentives at the market. For these companies, it's pretty clear another ad campaign wouldn't address their problems.

Without such a brand-specific market model, it's well-nigh impossible to find a pragmatic way through hoary old dilemmas such as the need to balance initiatives which influence sales directly (eg promotions) against those which position the brand within the market more generally; and the overall need to balance long-term brand-building against short-term financial results.

However the worst thing about this debate must surely be that it diverts attention from the critical point: marketing and advertising effectiveness is a function of corporate effectiveness.

Payback

When a company has something genuinely superior to offer its customers (and its marketing is in tune with this offer) the marketing works and the ads generate payback. When the offer is indifferent or inferior, they don't. 'Building a brand' can be an essential part of the wealth creating loop, helping to create, communicate, exchange and realise value. However, sometimes it degenerates into an attempt to hide sameness rather than celebrate difference.

Put exactly the same marketing people and agencies, using the same skills, tools and techniques, and the same levels of spend, to work in these two different contexts and the results will be as chalk is to cheese.

When brand building is part of the process of delivering 'demonstrable product superiority' as Procter & Gamble used to call it, it works. When it loses sight of this value raison d'être it doesn't.

The key issue, then, is not "to advertise or not to advertise?" but how to make sure – as economic circumstances and customer needs change – that you've got something worth advertising. And this holds true, recession or not.

FINANCIAL REPORTING **UPDATE**

The impact of FRS 17

Although full implementation of FRS 17 Retirement Benefits is not until June 2003, it is being introduced by instalment. Hence finance directors in companies with defined benefit schemes should be aware that early tranches of disclosures relating to this planned new standard are already due, as **David Chopping** explains.

Last year, we covered the introduction of FRS 17 Retirement Benefits. Unusually, this standard is being implemented in instalments. The first tranche of disclosure came into force in June 2001, with a further tranche coming into force in June 2002, and full implementation in June 2003. Given the relative rarity of year ends from June to November, the first time the impact will really be seen is for December 2001 year ends.

Companies which only operate defined contribution pension schemes will not really be affected by the new standard. Companies with defined benefit schemes are the ones that need to be aware of the potential problems the standard may cause. It is worth emphasising that directors are responsible for ensuring that a proper process is in place to obtain the necessary information for FRS 17 disclosure purposes, which will involve extensive communication with various parties.

Pensions surplus/deficit disclosure

Subject to a few exemptions, FRS 17 requires that companies put the whole of any pension surplus or deficit on their balance sheet. For some companies that might have been a problem whenever it was introduced. But FRS 17 has also changed the way in which pension surpluses and deficits are valued. In particular, it requires assets of the scheme to be valued at their market value at the company's year end. Given that many pension schemes invest primarily in equities, 2001 was probably not the year most companies would have chosen for this change. Many companies are looking at substantial pension deficits on an FRS 17 basis.

For 2001, companies are required to disclose the amount of any pension deficit on an FRS 17 basis, although the balance sheet will still be based on SSAP 24. The same applies from June 2002, except that companies will also be required to provide details of the movement in their pension deficit (or surplus) in the year. It is only from June 2003 that companies will be required to account for their pension schemes in accordance with the new standard. But it would be unwise to underestimate the amount of work needed to produce the disclosures in 2001 and companies should ensure that a proper process has been put in place.

Companies are allowed to adopt the standard in full early, but are unlikely to do so, at least for 2001. In order to comply with the new standard in full, companies would need to have information about the position of their pension schemes at previous balance sheet dates, for comparatives and opening balances. The costs alone of obtaining this information would put many companies off early adoption.

Instruct actuaries in time

Even though companies currently need only to disclose information about their pension position, there are still problems. The first and most basic is the need for a process to instruct actuaries and investment custodians to provide the information on a timely basis. FRS 17 involves a lot of work for the actuarial profession, and means that companies require information about their schemes more quickly than before. It is therefore vital to send out the necessary requests to actuaries on a timely basis. There are already suggestions that some companies may not obtain the information in time for the publication of their annual report. If this is the case, many of the companies affected might end up with qualified audit reports.

Where the information can be obtained, it remains to be seen how the markets will react to the information provided. Many companies will be showing substantial deficits. While these will not appear in the balance sheet, the markets will take them into account in company valuation. Well-publicised cases such as that of Boots indicate that companies are already acting to prevent problems arising.

Another issue is to agree with the actuaries that they will provide single figure best estimates rather than just ranges. Where a range is provided, it should not mask any inadequacies in the company's process for informing the actuaries of significant events or changes to the scheme.

Legal issue on dividend payments

There is also a legal issue on payment of dividends. Whether or not dividends can be paid depends on a company's distributable profits. These are normally based on the company's accounts, (not the group accounts, where these are produced) although they may differ from the company's profit and loss reserve. From June 2003, the accounts will need to include the amount of any pensions deficit, which may cause problems for some companies. This issue is addressed in FRS 17, but only by the comment that companies in this position should seek legal advice.

However, is the problem that far away? If a company produced accounts in 2001, or if it does so in 2002, that make it clear there is a substantial pensions deficit, which will need to be accounted for eventually, can the directors ignore this information in proposing a dividend? This question is being considered by an ICAEW working group and further information is expected to follow in due course.

David Chopping is the technical partner of Moore Stephens, London. He is a member of the technical and practical auditing committee of the Audit and Assurance Faculty.

FORTHCOMING FACULTY EVENTS – 2002

To attend any Faculty event, please fill out the form which adjoins this page, remove it by tearing along the perforation, and mail it or fax it to Kirsten Fairhurst at the Faculty's address given on the bottom of the form.
If you have any queries relating to these or other events, please contact Kirsten Fairhurst on 020 7920 8486.

- **11 February** EVENING LECTURE (London Guildhall University)

  'STRATEGIC MANAGEMENT: NO ACCOUNTING FOR PRACTICE' – PROFESSOR LEE PARKER, ADELAIDE UNIVERSITY.
  Lee Parker draws on his experience as a consultant and academic to analyse the role of the management accountant in business. He identifies the skills needed by management accountants to become leaders of business. Registration 5.45pm; lecture 6.00pm; refreshments and networking 7.00pm.
  This is an event organised by London Guildhall University's MSc in Strategic Management Accounting.

- **18 February** EVENING LECTURE (Chartered Accountants' Hall, London)

  'VALUEREPORTING – A REVOLUTION?' – DAVID PHILLIPS, PRICEWATERHOUSECOOPERS.
  This lecture looks at some of the issues raised by David Phillips in his article in the December issue of *Finance & Management* (see 'Developing a way to show corporate value' on page 7) including the information that investors need, how to manage for value and the benefits of greater transparency. Registration 5.45pm; lecture 6.00pm.

- **27 February** EVENING LECTURE (Chamber of Shipping, London)

  'STRATEGIC DYNAMICS – SURVIVAL OF THE FITTEST – BUILDING TOMORROW'S BUSINESS' – KIM WARREN, LONDON BUSINESS SCHOOL.
  Managers are faced with a range of strategy approaches and tools. Kim Warren introduces 'strategy dynamics' as an innovative approach to strategic management that combines systems dynamics thinking with a rigorous fact-based view connecting the fundamentals to performance outcomes. Registration 6.30pm; lecture 7.00pm, followed by refreshments and networking.
  This event is organised by The Association of MBAs, and is open to Faculty members.

- **13 March** HALF-DAY INTRODUCTORY MEETING (Birmingham City Football Club)

  'BEYOND BUDGETING – HOW MANAGERS CAN BREAK FREE FROM THE ANNUAL PERFORMANCE TRAP' – JEREMY HOPE, CAM-I.
  Adopting 'Beyond Budgeting' has far-reaching implications for employees, customers and shareholders, as well as for the organisation's leadership and management processes. Jeremy Hope, the programme director of CAM-I's Beyond Budgeting Round Table, introduces the BBRT research and discusses its findings and its success. For further details, please refer to the FFM events brochure, January – March 2002 (in this month's mailing). Registration 9.15am; meeting 9.30am to 12.30pm.

RECORDINGS OF FACULTY LECTURES

The following lectures and conferences held by the Faculty in 2001 are available, in both **audio** and **video** format.

To obtain a recording, please tick the audio and/or video box on the tear-off response form opposite.

There is a charge of £5.00 for audio recordings and £10.00 for video.

CUSTOMER RELATIONSHIP MANAGEMENT

Professor Robert Shaw of Marketing Best Practice International Ltd describes the critical success factors and the role of financial management in the investment of CRM.

THE BALANCED SCORECARD

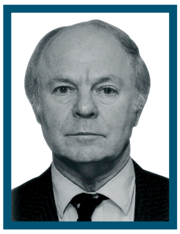
Robin Bellis-Jones of Bellis-Jones, Hill & Prodacapo shows how the balanced scorecard has enabled the vision of a strategy-focused organisation to become a reality.

BUDGETING AND PLANNING FOR THE 21ST CENTURY

John McKenzie of Armstrong Laing explains the increasing inability of budgets to deliver, and explores ways for companies to develop more dynamic budgeting processes.

To boldly lead...

In the latest of his series of articles on leadership, **Richard Alston** identifies some areas where strong leadership must essentially shape events to enable management to function.



Dr Richard Alston ran an international strategy consultancy before his recent retirement. He is now holding distance learning MBA (Management) courses for a private university.
Email: rabath@supanet.com

Management guru Peter Drucker cites a real case to show how weak leadership can be disastrous for an organisation, or even an economy, whilst boldness can be transformational.

Eugene Meyer, chairman of the Federal Reserve under President Hoover, always maintained that the Great Depression had been avoidable, says Drucker. The US economy was recovering from a mild recession when Europe crashed, causing a run on the banks. Meyer believed this run could be halted by just printing more money which, pretty soon, people would be forced to bank.

Hoover, however, claimed to be “a lame-duck president”, telling Meyer that immediate action required the sanction of the president-elect, Roosevelt. The latter, in turn, asserted “This is Hoover’s watch”. Meyer, feeling unable to implement his plan without approval, did nothing. But, with hindsight, he always believed he should have acted, and that doing so would have averted the Depression.

Later Meyer’s daughter Katharine Graham, as owner and de facto editor of the Washington Post, sought no-one’s permission before adopting the high risk policy of investigating Watergate. In the process she became a principal agent in the downfall of Richard Nixon. The management lesson here, says Drucker, is to “Go ahead and do things. Don’t ask for permission because that implies the other fellow can say ‘no’. You have to take the risk.”

In a rather more prosaic example of poor leadership, my bank recently took 16 months to rectify its erroneous removal of monies from my account. Although only 16 miles apart, for operating purposes its local administrative branch and the regional office existed on different planets.

Further, there were no boundary management procedures enabling common customer relationship management (CRM) approaches, nor any ensuring that all segments of the organisation talked to one another. Exposed to such situations, ‘best’ clients and ‘best’ suppliers will tend to slip away.

The leadership task

Basic organisation structures must address five elements:

- *task* – the organisational purposes, manufacturing, services etc;
- *people* – noting that things done by people change with technology;
- *technology* – both the technical tools and the problem-solving systems;
- *structure* – the systems of authority, communication, and work flow; and
- *environment* – the end/beginning of all transactions made by the organisation across its boundaries, external and internal.

The leadership task at the centre of the structure is not solely to set organisational goals and to establish a balance between the first four elements but also to define, establish, and monitor both the organisational/environmental boundary and the internal environmental boundaries. As we have seen, Eugene Meyer felt constrained (managed by) the boundaries of presidential relations, while his daughter Katharine Graham did not.

Boundary management needs leadership skills to see and identify the problem, and to act on the need, on occasions without a specific remit. It needs advanced listening and negotiating skills. Above all, it frequently asks people to take risks in uncharted waters. Good leadership will identify the boundaries, which, with constant change in the organisation and its environment, will never be static.

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