

# Concepts...

"Concepts" is published by Daedalus Oversight to raise as many questions as it answers. It is driven by the belief that the industry, its products and its services are ever evolving. The ideas reflect the challenges faced in the continuous journey of innovation and improvement.

## The Dullness in Accounting:

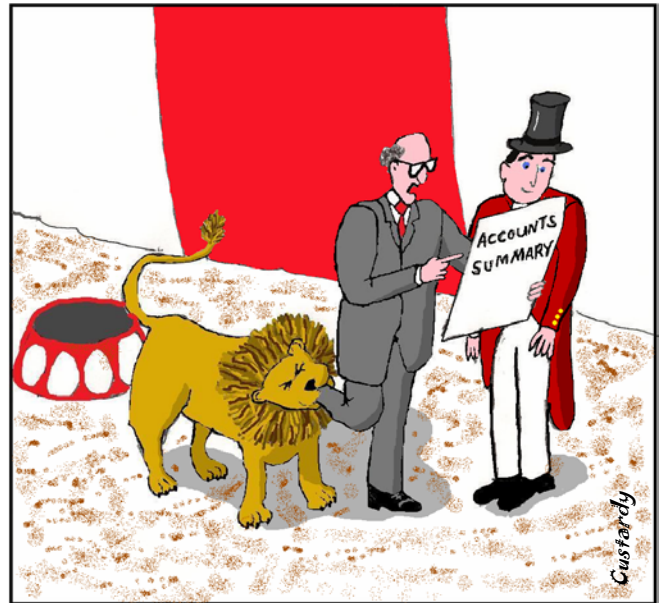
*"You see, our experts describe you as an appallingly dull fellow, unimaginative, timid, lacking in initiative, spineless, easily dominated, no sense of humor, tedious company and irrepressibly drab and awful. And whereas in most professions these would be considerable drawbacks, in chartered accountancy they are a positive boon" - career advice for Mr Anchovy (an accountant and aspiring lion tamer) - Monty Python's Flying Circus.* Accounting is an easy target for the comedians, yet this lampooned profession is the legally required back-bone of all successful business.

The need to 'account' for everything in today's business world can trace its origins to the double entry accounting methodology developed during the Renaissance. The power and usefulness of accounting may have created an unintended consequence. So powerful are its methods and its ability to allow a business to be analyzed that, firstly, the information is centralized in most companies and controlled from the top. Secondly, the definition of accounting standards and review of accounting documents is overseen, effectively, by external experts. Both these actions have removed the role of accounting from day-to-day business.

Beyond the external groups of experts, accounting is poorly understood, and is often seen as a means to an end or a necessary evil. With Accounting separated from the business, its priority becomes the escalating arms race of competitive forces generating action and counter action between corporate accountants preparing the books to accommodate the scrutiny of stock analysts; regulators trying to ensure fair practices with more rules; financial firms inventing new products to arbitrage regulations and accounting bodies opining on the progressively more complex methods of 'standardization'. A businessman needs an Accountant in order to conform with accounting regulations and standards rather than to help manage the business.

The reality is that many a business manager within a company has responsibility for P&L but rarely has responsibility for the balance sheet or cash flows. If he/she is lucky, there may be a published limit to assets and the cash flow is governed by revenue and expense targets. In some ways this is sensible, because although income problems can hurt a company, it takes a real asset/liabilities or cash flow disaster to bring a company to its knees. This, however leads to another problem.

In many industries and particularly the financial services, managers are rewarded for revenues only and not the whole financial consequences of their business. The central senior management, one step removed from the business, is responsible for linking and reviewing the impact of the business to the balance sheet and cash flow. This sets up a potential disaster for mismatched priorities creating mismatched Assets & Liabilities. In the pursuit of a vibrant economy and corporate revenue growth, the Asset/Liability mismanagement fed by a government subsidized lending program



*Although 'Leo' appears to be a Liability, he is, in fact, a performing Asset!*

drove the structured product, special investment vehicle, credit default swap, shadow banking, credit crisis that we are living with today.

Daedalus Oversight proposes that all products/businesses within a company should be tracked as individual balance sheets which can then be aggregated for the larger corporation. The accounting needs to be brought to the front of a business, not created as a reactive afterthought. For any investment fund (Hedge Fund or Institutional), the accounting plan should be tagged to every transaction as it happens. With today's technology, the goal of real-time accounting and valuation should be possible. There can still be centralized guidance and control but, with this methodology, the individual businesses will be directly responsible for the return on assets and the cost and investment of capital.

With the exciting prospect of creating a real time world of accounting data, Mr Anchovy might be tempted back from his desire to become a lion tamer after all. The approach on how this can be achieved is the subject of the next newsletter.

Paul F. Dowding

*Daedalus Oversight would be pleased to discuss the realization of these concepts with you further. We thank you for your consideration.*

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