ACCOUNTING AS A 21ST CENTURY BUSINESS VALUE DRIVER

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Abstract: Companies have focused for decades on maximizing the value creation process of direct productive business activities. The information revolution has left its mark and has started an irreversible transformation of classical business processes and activities. In the new 21st century information and data driven society, commodity is value and knowledge, making Porters value chain concept an important key factor for successful and innovative businesses. Business value creation was during the industrial revolution a topic strictly liked to direct productive activities. The increased and transformed business environment required innovative and sustainable competitive advantages for business organizations. The indirect productive business activities, and the business support services have been considered business value consuming and having no contribution towards the company value chain. 21st century accounting has evolved from the role of record keeper to a business value driver that assures and contributes to the company value chain by using its internal knowledge pool. The existing scientific publications are approaching accounting from different perspectives and support the main conclusion of the paper: accounting, in the 21st century is not a “bean counter” anymore, accounting is a certain and consistent business value driver.

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Introduction

The activities within any company are direct productive and indirect productive, or business services directly linked to the outcome of the company and business support services that support and enable the smooth and plane business operation.
The 21-st century, also known as the information revolution century, where the information revolution has made its mark on the classic approach of doing business. Information and information management has become one of the key “commodities” of the modern, profitable and efficient company. Information management has become the defining element of the modern, efficient and sustainable business.
Any activity with a company must have a productive, useful, and efficient outcome regardless of the direct or indirect relation to the business output and core activity.
The purpose of this paper is to show that indirect productive business activities, also known as business support services, are 21st century business value drivers that need to be handled with care, properly managed, and measured.
Accounting is a “classical” example of indirect productive business activity that will be used to demonstrate the research hypotheses of this paper. The research hypotheses of the current paper are:

- Accounting activities as knowledge based organization
- Accounting activities as a business value generator
- EVA of accounting activities

Genesis of accounting

Concerns of numeration and counting can be traced back to the early development stages of human society. The development and establishment of states and authorities that have as a basis a form of taxation as a public income have necessitated besides the knowledge of numbers also the knowledge of calculation and counting. The need of recollection of numerical topics can be considered as a very early form of keeping accounts and records. This need of keeping records of numerical facts has laid the foundation of the science of accounting.

In 1495 Luca Pacioli published in Venice his book “***Summa de arithmetica, geometria, proportioni et proportionalita*** (*Summary of arithmetic, geometry, proportions and proportionality*)” that was a comprehensive summary of Renaissance mathematics, including practical arithmetic, basic algebra, basic geometry and accounting, written in Italian for use as a textbook. (Wikipedia, 2017). In one of the sections of his book about business, the section *Particularis de computis et scripturis* (*Details of calculation and recording*) describes the accounting system used by the Renaissance Venetian

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merchants and this is one of the first documented sources about the today's double entry accounting system.

Since Pacioli was a Franciscan friar, he might be referred to simply as Friar Luca. While Friar Luca is often called the "Father of Accounting," he did not invent the system. Instead, he simply described a method used by merchants in Venice during the Italian Renaissance period. His system included most of the accounting cycle as we know it today. For example, he described the use of journals and ledgers, and he warned that a person should not go to sleep at night until the debits equaled the credits! His ledger included assets (including receivables and inventories), liabilities, capital, income, and expense accounts. Friar Luca demonstrated year-end closing entries and proposed that a trial balance be used to prove a balanced ledger. (Smith, 2013, p. 2).

Role and fields of accounting in business organizations

Accounting is also known as the "language of a business" because it communicates the information that owners, investors, managers and government use to evaluate the business performance towards the ultimate business goal to create value for its stakeholders and shareholders.

The generic role of accounting can be defined as a sum of three key activities: record, report, and interpret financial data that are used for business decision making.

The key basic activities of accounting can be challenging, especially in the dynamic changing, globalized markets. The recording and reporting of financial data is made easy by the 21st century modern accounting software packages, that enable a more standardized and uniform approach to accounting rules and standards. The recording and reporting of financial transactions, also known as financial accounting, is governed by standardized rules and regulations defined by fiscal and tax authorities and accounting organizations. Governments define the fiscal and tax rules and regulations for their economic environments, that every business organization must follow.

Independent worldwide recognized organizations like FASB (Financial Accounting Standards Board) that have issued GAAP (General Accepted Accounting Principles) that are widely used, with local variations, in the Anglo-Saxon countries. Due to internationalization and globalization of business and financial worlds the IASB (International Accounting Standards Board) have issued the IFRS (International Financial Reporting Standards) that are widely accepted and used by European companies and non-US-based companies.

Due to an ever-increasing business complexity that implies a more and more globalized approach and because of the fully internationalized capital and financial markets companies worldwide are starting to adopt IFRS as an accounting standard.

Because of the needed standardization of accounting principles, the development of modern accounting software has made the recording and reporting of the financial statements, also known as financial accounting, more simplistic, standardized and streamlined. The recording and reporting of financial data has become today a "commodity," a standardized process that will evolve and develop into a world-wide standardized process that allows easy comparability and understanding.

The interpretation, communication and management of financial data, also known as management accounting, is the more demanding and complex of the accounting activities because it is more flexible, it is not regulated so much by 3rd parties, and requires and particularized approach.

Accounting as an internal knowledge based organization

The key defining concepts of the 21st century are information and knowledge that have had a major impact on business organizations all over the world. Business organizations must redefine their strategies and their values to assure their competitive advantage in the increasingly fast moving global market place. (Daraban, 2016, p. 1).

A knowledge based organization is an organization where workers use processes and infrastructure to produce, change, manage, use, and share knowledge based products and services to achieve the organizational goal. (Daraban, 2016, p. 4)

The generic role of an accounting department is to record, report, and to read the financial data of business organization. Therefore, it can be concluded that accounting is meeting all the main characteristics of the 21st century knowledge based organization.

The accounting organization uses defined and established processes and infrastructure in the collection, recording, and reporting of financial data. The collection, recording, and reporting of financial data is strictly regulated by financial and fiscal authorities and is the main activity of financial accounting. The regulations need to be understood and implemented by the accountants for each specific business case or business model. The created records and reports are shared with internal stakeholders, that use the received information for the business and management decision process, and external stakeholders (like government, suppliers, clients, investors, etc.) that use the information for the business performance evaluation. Financial accounting is the form of reporting business performance, and value creation, in a form imposed by governments, that has transferred the business value creation through accounting to business entities for a price, taxes and fees. Financial accounting is a mandatory activity for all business activities, worldwide, having as stakeholders the business organization and the local fiscal authorities and regulatory state organizations. Because of its implications, possible penalties and legal responsibility, financial accounting can make or break a business if taken lightly. Non-compliance with fiscal regulations can lead to insolvency and bankruptcy. Therefore, financial accounting is a radical business value creator or destroyer through the knowledge and understanding of accounting rules and regulations.

Management accounting is using and "translating" the financial accounting information and received knowledge, in form of financial statements, into data that is used by and in the management and business decisions process. The "translated" financial accounting data, received in form of the financial statements, are reinterpreted by management accountants for the business value optimization process; one major objective being cost reduction, legal minimization of tax obligations.

Both accounting fields, that are quite different but serve a common goal, strive towards the achievement of the ultimate business goal of value creation by recording, reporting, and reading financial data. Financial accounting is more retrospective by analyzing and reporting on past business actions, whereas management accounting is using the past analyzed events and is trying to find the best options and alternatives to improve and increase the efficiency and value of the business.

One of the knowledge generators of the 21st century modern, knowledge and information driven, business organization is the accounting organization that records, handles, and disseminates information based business internal and external rules and regulations like an independent, external knowledge based organization.

Accounting as a business value driver

Value creation is the most important goal of any business activity. By assuring the continuous business value creation through stable, efficient and innovative processes the company safeguards its future and assures its competitive sustainable advantage.

Therefore, in an ever-increasing business complexity, globalization and internationalization of business processes and transactions business organizations must tap and assure that all available and available resources are used at their maximum efficiency and effectiveness.

To be able to survive companies must develop mid and long term strategies that give them the sustainable competitive advantage by efficient and profitable set up of all involved business processes.

"Competitive advantage cannot be understood by looking at a firm as a whole. It stems from the many discrete activities a firm performs in designing, producing, marketing, delivering, and supporting its product". (Porter, 1985, p. 33)

In his book, Competitive Advantage, Michael Porter is defining primary and support activities as being contributors to the "margin," and profitability of the business. In the defined value chain, under Firm Infrastructure he mentions the business support services as being the services that support and sustain the rest of the business. The contribution of business support services towards the creation of business value has been recognized and determined by Porter in his book, Competitive Advantage, 1985 where he introduced the value chain concept. In the value chain concept, the support services, which also include accounting, are listed under support activities that contribute to the margin of the business.

Triggered by the information revolution and by the huge developments and changes in information management and IT systems and infrastructure the classical concepts have been undergoing an irreversible change and development process.

At the time when Porter introduced the value chain concept as being the sum of all discreet business activities, in 1985 the impact of the information revolution and information technology was in the early stages, at that time the business activities have been seen in their classical view.

The support services, including accounting, have been understood in the "classical role." Accounting has been seen and defined as a record keeper and nowhere close to the value driver role of the 21st century. Since 1985 accounting has been going through major changes in concepts, understanding of business transactions and use of accounting tools.

Accounting has been undergoing major transformations determined by the internationalization and globalization of businesses and of the increasing complexity of business transactions. Today's financial accounting is characterized by the following aspects that reflect Porter's value chain and is contributing to business value creation and margin increase:

- Financial accounting is following besides the local statutory fiscal and financial legislation, IFRS principles that allow a standardization and comparability of financial statements almost worldwide determined by globalization and increasing internationalization and complexity of business transactions
- Today's financial accounting systems enable a higher standardization and commoditization of transactions recording by elimination of points of failure and increase of transparency
- Most of the today's modern financial accounting systems are real time systems, most transactions are visible and show their business impact
- Statutory reporting is automated and is supported by the integrated ERP's
- The understanding and interpretation of the financial data and financial accounting records can be enabled by usage of business intelligence software tools that allow an automated transformation of data and financial records for decision making and business analysis

Because of the transformations that the support services have been going through the classical approach of support services has suffered a dramatic change. Accounting has developed from the classical role of record keeper to a real business value driver. The business value driver role is conditioned by the development and adoption of:

- Modern information and management systems that enable and support rapid and accurate recording, dissemination and interpretation of the financial data used for management and business decisions
- Value based management that implies a consistent change in the view of classical concepts of business and management, the business activities (primary and secondary activities) need to contribute to the growth, profitability, and efficiency of the company

A value driver is an activity or capability that adds worth to a product, service or brand. More specifically, a value driver refers to those activities or capabilities that add profitability, reduce risk, and promote growth in accordance with strategic goals. (Rouse, 2016)

The considerations and developments of the 21st century has put accounting into a new position that added to the classical role of accounting features that enabled the transformation of the classical view. The modern accounting meets has benefited from the information revolution; data recording and dissemination has increased in speed and accuracy that enabled value creation by information availability in due time for the business and management decision process.

Valuation of accounting services

Value is not easy to determine, especially if we are talking about intangibles. For tangibles, fixed assets, one way of determining the value is by evaluating its intrinsic value. For the intangibles, immaterial assets it is not that easy to have an objective value.

IAS 38, issued by the International Accounting Standards Board, defines the characteristics of intangibles assets.

Intangible asset: an identifiable non-monetary asset without physical substance. An asset is a resource that is controlled by the entity as a result of past events (for example, purchase or self-creation) and from which future economic benefits (inflows of cash or other assets) are expected. [IAS 38.8] Thus, the three critical attributes of an intangible asset are:

- identifiability
- control (power to obtain benefits from the asset)
- future economic benefits (such as revenues or reduced future costs)

Identifiability: an intangible asset is identifiable when it: [IAS 38.12]

- is separable (capable of being separated and sold, transferred, licensed, rented, or exchanged, either individually or together with a related contract) or
- arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

(Deloitte Global Services Limited, 2017)

Based on the definition of intangibles, accounting activities, are meeting most requirements. Accounting activities are only indirect identifiable through the human resources, specifically the finance professionals that are performing the activities. As an employee of the company or as an outsourced activity the accounting activities are under the full control of the firm. The future economic benefits are very clear, without accounting activities the firm would not be able to operate legally nor would it have needed financial information about business operations, if we consider the different accounting fields, financial accounting and management accounting.

Under the IAS 38 definition we could assume that the involved human resources in accounting activities are the assets that the firm has bought and invested.

An invested capital, in this case in accounting staff and systems, is expected to have a contribution towards the value creation of the firm. Common indicators to measure the return of invested capital and the value addition of the invested capital are ROIC (return on invested capital) and EVA (economic value added).

ROIC is defined as the ratio that shows how profitable the invested capital is turned into profits whereas EVA is defined as a measure of surplus value on the investment.

ROIC and EVA can be determined per the formulas from below:

ROIC = NOPAT / IC ➔ NOPAT = ROIC * IC

EVA = NOPAT - CC = NOPAT - (WACC * IC) = (ROIC * IC) – (WACC * IC) = IC * (ROIC-WACC)

Where

ROIC = return on capital employed

NOPAT = net operating profit after tax

IC = invested capital

WACC = weighted average cost of capital

EVA = IC * (ROIC-WACC)

The valuation of the contribution of accounting services cannot directly be determined, the services being indirect productive and not having direct impact on the sales of the firm. Therefore, it can only determine when EVA is positive, when value is created and accounting is contributing to the value chain of the firm.

ROIC – WACC > 0 ➔ EVA > 0 the company is creating value through its growth and assures that the expectations of investors are met.

ROIC – WACC < 0 ➔ EVA <0 the company destroys value and needs an immediate adjustment of operations

WACC is the minimal level of return on invested capital where no EVA is generated by business development and growth.

For accounting services, it can be considered that the invested capital is the total amount paid as salaries for the accounting team as a way of procuring the needed and mandatory resources, knowledge in the case of accounting activities. Financial accounting is mandatory for most of the world markets being imposed by financial and fiscal local authorities; it can be considered as being the cost of doing business in a specific market, cost that is being paid to the market regulator and supervisor.

To have a legal running business that is based on sound economics and profitability, the minimal return on invested capital would be at least at the level of WACC, where EVA neutrality (EVA = 0) would be assured.

Conclusions

Value creation has become a central problem concerning enterprises. It is invoked mainly by shareholders, but also by managers and financial analysts, as it represents an imperative for the company, but also a key factor for justifying major decisions (for example, activity cessions, disinvestments operations, staff cutbacks, etc.). Value creation for the shareholders should be constant. (Petrescu & Apostol , 2009, p. 1)

The financial theory emphasizes the importance of maximizing shareholder wealth as the ultimate goal of business firms. At present the business environment is faced with numerous challenges that can have a major impact on the performance of firms. (Vasilescu & Popa, 2011, p. 1)

Companies are facing a major hurdle, to survive globalized and the complex business environment. Nowadays companies must excel in all their functional and organizational areas by creating a steady and sustainable flow of value. In their quest for value creation companies must reinvent themselves and innovate the classical way of doing business. Therefore, a detailed and very systematic analysis must be performed on all business processes and activities to assure that no growth and value creation potential remains untapped.

For decades' companies, during the industrial revolution, have focused mostly on the direct productive activities and their extensive development to assure growth and profitability. The impact and challenges of the information revolution, combined with the complexity, internationalization and globalization of business environments have led companies to focus and to maximize the value potential also from business support activities.

A company value stream cannot be considered only coming from direct activities, the economic value stream of a company is the sum of all value streams generated by all business activities direct and indirect.

Modern accounting, with its two major fields financial accounting and management accounting, have left their mark in the development of the company business. The transformation of the classical view of accounting as record keeper has started and is not reversible. During the information dominated markets and societies the accounting is providing business information post- and ante-fact that can and will be used by managers in the business decision process.

Accounting activities, financial accounting and management accounting, have a gain momentum in the business data and information delivery. The provided data and information about past and future business actions have a certain and business value. Management accounting is providing data and information, with help of modern IT tools, that are the basis of modern business intelligence.

Value is subjective and particularized especially for immaterial, intangible services from within business organizations. Economic Value Added (EVA) can be used as a tool for the determination and illustration of the value created by indirect business activities.

The output of accounting activities can be assimilated to the current definition of company intangibles due to increasing complexity and influence and impact of the modern IT systems and tools that make business information more and more available.

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