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Robert S. Gorab

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Effective Management Controls and Reporting Policies for the Multinational Company

by ROBERT S. GORAB
Partner, New York Office

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MANAGEMENT INFORMATION SYSTEMS (MIS) are essentially communication systems. One of the major problems confronting most companies today is the maintenance of sound communications, particularly in the financial area—getting the required information to the proper people at the proper time.

The world is shrinking, and with that development comes an increase in information need and a decrease in the time within which to respond or react to it. This problem, from an international point of view, is compounded by differences in accounting practices, reporting techniques, disclosure requirements, and language. At one time or another, the lack of such information can cause costly delays or result in an inability to respond to changes in economic or competitive conditions.

Most observers agree that there is a need for better management information and better decision-making data. Therefore, some of the concepts of MIS can be of benefit to companies, so long as they recognize that there are problems in applying MIS on an international basis.

Obtaining the data a company needs for decision-making at its head offices requires several things, including: greater specification of those needs; greater standardization of reporting practices; the establishment of more current and more easily understood instructions; more uniformity in data recording and reporting; more centralization of control over accounting and financial policy-making decisions; greater recognition of the ways of overcoming deficiencies; and, lastly, recognition of the limitations of foreign manpower and of the effect of rising nationalism.

MIS FOR THE INTERNATIONAL COMPANY

The term MIS is admittedly vague and one very much misunderstood. Moreover, while it is a desirable management tool, there are limitations to adopting it for international companies. For companies operating in an international environment, it is not always possible to develop immediately a full-scale management information system. Nevertheless, the total MIS concept should not deter international companies from studying, designing, and effecting certain fundamental, workable, and responsive financial management tools and reporting practices that are internal parts of any MIS. Some of these tools and practices are developed at a later point in this article.

WHAT IS MIS?

What is MIS? For many years, financial literature has been extolling the merits of such wondrous things as management systems, integrated systems, the systems approach, and management information systems. In some cases, the only differences are in semantics. Webster's Third International Dictionary defines management as "the executive function of planning, organizing, co-ordinating, directing, controlling and supervising an industrial or business project or activity with responsibility for results." Information is defined in Webster's as the "communication or reception of knowledge or intelligence." (Information that is not meaningful to some pertinent context is not knowledge.) A system is described as "a complex unity, formed of many diverse parts subject to a common plan or serving a common purpose."

If these three definitions were lumped together, a Management Information System might be described as "a vehicle the purpose of which is to receive, classify, and communicate knowledge in such a way as to permit a business activity to be efficiently planned, organized, co-ordinated, controlled and supervised." More simply, a management information system is an integrated set of data collection, accumulation, summarization, and analysis functions designed to ensure timely business operation, planning, and control, including the achievement of better utilization of information resources. Therefore, the general objectives of any management information system are: to determine what data, and the quantity thereof, are needed by the user; to gather the data in as meaningful, useful, and simplified a manner as possible; and to report the data on a timely basis to the user so that the data become meaningful information for decision-making.

THREE KEY CONCEPTS OF MIS

Aside from these three purposes, MIS also encompasses three basic concepts. The first is the establishment of a profit plan, or objective, which includes budgets, forecasts, responsibility accounting, and standards. In this context, MIS begins with the sales forecast. In a real sense, MIS represents a philosophy of operating a business.

The second concept is the establishment of a reporting system whereby all data are gathered in a meaningful manner to determine whether the goals and objectives have been attained and to provide key personnel with information needed to do their job.

The third objective is the establishment of an operating system to handle the activities and events that are occurring daily. This part of MIS is the working part, or the part that carries out the profit plan and identifies the functions taking place each day in selling, buying, constructing, and reporting.

MIS is user-oriented. It is intended to supply the user with decision-enabling data. It is more than an integrated data processing system. It is more than conversion to EDP. It is not merely a system providing management reports. It is not only a budget-control system, or a cash, sales, or production forecasting procedure. It is a system that requires a hard look at information needs, corporate physical activities, corporate plans, and the integration of all these. To express it another way, MIS is like the weaving of a multi-colored piece of fabric. That fabric doesn't become a coherent unit until all the threads fit into the proper place at the proper time.

The needs of the management information system, it is obvious, are also the needs of the basic corporate system. MIS is only the latest of a series of steps taken to find a means of being better informed. Moreover, MIS can be and is manually operated. There is no prerequisite that MIS be computer-based. In fact, there are many management personnel today who would say that computer-based MIS would be limited in scope. If I were to draw a conclusion here, it would be that the objectives for MIS are no different for companies operating domestically from what they are for companies operating both domestically and internationally.

There are, however, added problems and limitations for companies operating internationally. What are the factors that limit the adoption of a full-scale management information system for international companies? And what measures can be taken in the interim?

ADOPTING MIS ABROAD

There are a half dozen or so limiting factors in adopting MIS overseas.

First, indications are that the state of the art of data processing in most foreign countries is behind that of the United States. There is a significant lack of properly trained personnel and data center managers and programmers. Since many management information systems are planned to be computer-based, and since companies must ascertain the feasibility of being able to operate a large data system in a foreign country, this limitation gives cause for reflection.

Secondly, there may be resistance to a full-scale system by national political groups, or the host government itself may prevent it from becoming a reality. Such a system may be considered too radical or too revolutionary for some European or South American nations. The imposition of a management information system may lead foreign governments or political factions within the country to conclude that far too much control is being exercised by outside forces. They may feel this way despite the fact that economies may be achieved from having these highly sophisticated management information systems.

A third factor is that competent local managers may resent the removal of the decision-making process from their domain. It may serve to negate their initiative. It tends to restrict their independence, which is a long-prized possession.

Fourth, the introduction of a management information system could have, in all probability, a significant effect on the local labor force.

By association alone, it raises the question in the worker's mind of possible displacement. The removal of local autonomy may decrease the employee's loyalty to the company. Even worse, the host government may intervene in an attempt to protect its citizens from the results of short- and long-term replacement. This is not unusual or unexpected, especially when considered in light of the increasing demand of national governments for greater participation in management and more local manufacturing and employment.

Other factors that restrict MIS in one form or another include the differences caused by customs, attitudes, and environment. The typical Latin American "manana" attitude, differences in laws and regulations, and the inferiority of communication networks are just a few.

There is also one other major factor that leads me to believe that full-scale MIS for international companies cannot always be put into effect. It is the lack of a proven track record for MIS in the United States. Many of the expected benefits of MIS have not yet been realized. Many companies have had serious problems in effectively transforming glamorous ideas into workable systems. Computer capabilities and availabilities have been less than utopian. Management authorities have been denied many decision-making powers. There has been poor management of resources dedicated to systems planning. Economic benefits have been less than expected. Organizational problems continue to exist. And results have not always justified expenditures.

The circumstances and conditions aforementioned are only some of the hurdles that hinder the development of MIS overseas. Although many of these hurdles are not insurmountable, any movement towards MIS should be made only after a careful and guarded analysis of all relevant social, political, and economic factors. In the interim, companies should continue to work in the direction of achieving the principal objectives of any management information system, which are, as noted earlier, to obtain the data needed, in the form desired, for the proper people at the proper time, to enable them to permit the decision-making process to occur.

HOW TO ACHIEVE MIS OBJECTIVES

What is clearly needed to achieve these objectives? The key, perhaps, is the recognition by top management of the need to prescribe more clearly and with greater detail the form of information desired, how often it is needed, and the manner of gathering it. There are many tools available to management to meet the objectives of MIS. Among the more important ones is the creation and use of an effective chart of accounts. In any financial system it is essential that all foreign locations use a universal yet flexible chart of accounts, which would provide for the orderly gathering and consistent reporting of financial results and statistics. Included in this chart of accounts should be such essentials as account titles, account descriptions, and further breakdowns and procedural descriptions for critical financial items, such as inventories, cost of sales by products, fixed assets, insurance, taxes, and the like.

Another important management tool is a responsive and comprehensive accounting manual. The development of an accounting manual is vital. Among the things that the manual should set forth would be the duties of key financial personnel, such as those of the treasurer and comptroller, including a statement concerning the limits of their authority. It should also set forth the procedures to be followed in concluding contracts, signing leases, and acquiring insurance, and should include a designation in each case of the limits of authority and the procedures to be followed when those limits have to be exceeded. Such a manual could set forth the procedures relative to filing tax returns and settling assessments. This could be expanded to provide that the corporate head office receive copies of all tax computations, tax returns, tax laws, and tax regulations.

The manual could set forth compensation policies and could include practices to be followed for vacations, home leave, travel expenses, transfer costs and the like. The policy with respect to retaining legal counsel should also be set forth in the manual, including a provision for head office approval. Capital expansion and appropriation and retirement policies should be clearly established. A uniform basis for computing return on investments could also become part of the manual.

MEASURING FOREIGN EXCHANGE LOSSES

Last, but certainly not least, in any list of financial management tools is effective reporting of foreign exchange. Management's responsibility for safeguarding corporate assets in an international environment takes on added dimensions. Because of the effect of political and economic trends on foreign exchange rates and the need to obtain favorable remittance, management must (1) measure the exposure to exchange losses; (2) forecast foreign currency trends; and (3) initiate procedures to avoid or lessen unavoidable exchange losses.

Before these three functions can be carried out, however, a more basic determination has to be made. And that is, what group or individuals shall oversee foreign exchange matters? Should it be the financial officers, the directors, the treasurers, the comptrollers, or the exchange committee? The choice is obviously an important one. And I cannot say generally whether the individual or the committee approach is preferable. Whatever choice is made, however, it should provide for head office management, and it should not result in complete relegation of responsibility to local management.

Policies also must be established that set forth the basic criteria for determining what assets are or are not to be protected through exchange contracts, and so forth, from the effects of exchange movements. After over-all policy has been set, the first procedure to follow is to measure foreign-exchange exposure.

This exposure-measurement procedure merely segregates the assets exposed, determines how the existence of many local liabilities serves to minimize the exposure, and then estimates the exchange loss that might occur with respect to those assets at an estimated unfavorable rate of exchange.

Secondly, I noted that management has a responsibility to forecast foreign currency trends. This requires a careful watching of such things as balance-of-trade situations, an unfavorable trend in the balance of payments, recurring national deficits, rising interest rates, and other economic indicators.

The third responsibility—that of minimizing exchange losses—requires a clear understanding of a company's cash needs, cash availabilities, borrowing facilities, dividend policy, and credit and collection status. One way of minimizing exchange losses is to remit as much cash as possible for the payment of dividends, either on a provisional basis or through an early declaration date. Another way is to concentrate on the collection of receivables in national currencies. A third way is to borrow locally, and attempts should be made to do this to the extent possible. A fourth way is to produce or buy as many products as possible locally. Where the cost of forward exchange contracts is not excessive, efforts should be made to purchase such contracts to cover exposed assets.

In the final analysis, if a great deal of a company's buying is from U.S. suppliers, requiring U.S. dollar output, and if a significant portion of the selling activity is conduced in the local market, providing input of local currencies, many of the company's local assets are exposed to sudden changes in the economic value of those assets. Hence, a company must constantly be aware of its exchange exposures and take steps to protect itself against losses.

AN EFFECTIVE REPORTING SYSTEM

In addition to the management tools already mentioned, an essential part of any management information system is an effective reporting system. The development of this tool is critical to good financial management and critical to any management information system. What those reports should look like, and what they might say, cannot be generalized. Businesses and systems vary so that standardization is not possible. What are common, however, are some of the ground rules and characteristics that exist in all successful reporting systems.

Of all the ground rules and characteristics, there are eight worth noting.

First, the report must provide only the information that is necessary and digestible. It must make the transition from the reporting of past results to establishing a future course of action. The report must be alive and not just ready for preservation at the Smithsonian Institution. A report must tell whether a profit plan, a capital investment plan, a marketing plan, or any other plan is being effectively carried out. Therefore, reports must be related to a clear and viable frame of reference—a plan. It must tell the reader the information he needs to know to control his next decision, if one is to be made. For example, if planned construction is not being completed on time, management must know this since it affects financing costs, the over-all production plan, the hiring policies, and other related factors. Consistency in reporting must be achieved in order that meaningful comparisons can be made with the profit plan and the budget. Reports must show results on a responsibility basis to each level having a need for information. Reports must tell each user whether his responsibilities are being discharged and must provide him with the information to do his job.

Each level of management must be able to see and evaluate factors within its control. For example, sales, gross margin, and marketing expenses must be reported to the vice president for marketing for the report to be meaningful and to form a basis for decision. Responsive reporting systems must, for each level of responsibility, segregate the extraneous information and identify the effect of factors that are beyond the immediate control of the report recipient. For example, the report to the vice president for sales must segregate the effect on sales of factors outside his control, such as planned construction delays, delays in hiring personnel, or delays caused by shipping strikes. Obviously, he cannot be responsible for these events.

The reporting procedure must be timely. Reports must be generated in accordance with a predetermined timetable and in order to permit effective actions must be in the hands of responsible parties promptly. The reporting system, at least with respect to the financial side, should be developed in such a way as to follow the chart of accounts. Tying the reporting system in with the chart of accounts not only promotes better understanding of the reported information, but also permits a more effective consolidation of operations.

To the extent possible, report format should be standardized and the frequency of preparation determined.

And last, reports must in all cases indicate whatever detail information may be required for filing financial data with the Securities and Exchange Commission or other regulatory bodies. This could be done on an annual basis or more frequently, as is done with proxy filings or the filing of registration statements.

DIVERGENT ACCOUNTING PRACTICES

Aside from the difficulties of developing international information systems, there are problems caused by the numerous divergent accounting conventions between countries. Management must know whether the accounting practices of the countries in which its companies operate are the same as, or differ from, those in the United States. The need to consolidate the accounts of subsidiaries in an annual report, the need to conform the local practice to the U.S. practice for such consolidation, security filings, and filings with the U.S. Department of Commerce, all require an awareness of the accounting differences that do exist.

In most cases, companies will find that many differences in practice do exist between countries. For example, many countries allow for currency inflation in accounts by recognizing appraisal value or revaluation adjustment based on indices. There is also a commonly accepted practice in many of those countries to permit depreciation to be based on the restated property accounts both for financial and tax purposes. Although this practice is reasonably widespread throughout Latin America, it is not generally accepted as proper accounting in the United States.

Another example: Reserves are used quite extensively in many European countries to achieve highly conservative results in good years. These reserves, in bad years, could be used to stabilize profits or level income to maintain investor or creditor integrity. The secret reserves may be for replacement of inventory, general contingency, or conservative valuation of inventory. For example, in Sweden the inventory can be valued as low as 40 per cent of cost.

In Europe and South America it is a common practice to set aside legal reserves also. This reserve is usually built up by deducting specified percentages of net profits until the reserve reaches a specified level of capital. A number of countries permit tax deductions for depreciation on construction in progress. In the U.S. this is unheard of.

There are, of course, other differences between the practices we follow in the U.S. and those followed overseas. Some others include nonacceptance of certain inventory valuation methods, absence of tax-effect accounting, depreciation of fully depreciated assets, and prevention of a company's dealing in its own shares.

The question might arise: Why don't companies operating in foreign countries use U.S. standards of accounting? The answer is that despite efforts to achieve uniformity, doing so is highly impractical and not always possible. One set of principles would tend to be contrary to the economic pattern or motives of the countries concerned. Blind conformity cannot be justified. Accounting principles mirror the economic discipline of each country. For example, if a company followed U.S. accounting policy in Brazil, or any other country undergoing serious inflation, records would show all fixed assets at cost. In Brazil this would be misleading. The intent in Brazil and other countries undergoing inflation is to record and depreciate on a realistic basis, which it is hoped will keep pace with replacement costs. If a company followed U.S. accounting in the Netherlands and did not recognize depreciation on construction in progress, such practice would be contrary to the intent of the tax laws, which obviously is to encourage replacement and improvement of production facilities.

For example, in the United States the disclosure of a significant loss on the sale of an investment in plant or securities would normally require disclosure in the reports to the reading public and would generally be charged to income. In many European countries this same loss may not be disclosed. This would be in keeping with their philosophy of not upsetting the stockholders or the creditors. In Japan, in fact, the loss may be deferred and amortized by charges to income in the future.

Corporate managements, knowing that these differences in accounting practice exist among foreign countries, have a vital interest in seeing to it that their reporting systems at international locations provide them with all the necessary information. This would include the data necessary to restate the financial statements of those locations on an accounting basis acceptable in the United States for reports to shareholders and U.S. regulatory bodies, such as the Securities and Exchange Commission and U.S. Department of Commerce. If the reporting procedures and accounting manuals do not provide for the gathering of this information, much management time will be lost and many delays in reporting can occur in developing consistent and acceptable financial data.

Further support for the concern that management must show with respect to these differences in accounting practices can be found in information that the International Finance Corporation, an affiliate of the International Bank for Reconstruction and Development (World Bank), is requiring in periodic financial reporting. The Bank is requiring specific information from its borrowers with respect to variations in their accounting practices from those prescribed in the U.S. The variations it specifies be disclosed, if they exist, are:

(a) Significant understatement of assets and overstatement of liabilities

(b) Use of other than historical cost for assets such as plant and equipment

(c) Practices that equalize reported income over several periods

(d) Gains and losses that have been excluded from income

(e) Treatment accorded exchange losses

CONCLUSION

In conclusion, it can be said that management information systems are highly desirable tools. Short of that, however, international companies can achieve many of the goals and objectives of MIS by designing and maintaining a current accounting and reporting system that can provide the information desired, in the proper form, to the proper people, at the proper time. With an awareness of the exchange exposures involved, the differences in customs, laws, language, and accounting practices in foreign countries, a company can move a long way towards effective financial management.