

CORPORATE GOVERNANCE AND CONTROLLING - A GERMAN PERSPECTIVE -

Carl-Christian Freidank, Patrick Velte***

Abstract

This article is focused on the interdependencies between corporate governance and controlling from a German perspective. An impact analysis based on the area of auditing, supervision and control will follow. Using the example of intangible assets and long-term manufacturing contracts according to IFRS, the influences of internationalisation on controlling will be presented. The details show that the development of financial accounting into an integral business reporting system together with an increase in importance of controlling goes hand in hand. In the future, controlling will form the central link between corporate governance and business reporting.

Keywords: Corporate governance, controlling, financial accounting, business reporting

* *Holder of the chair for "Revisions- und Treuhandwesen" and the managing director of the "Institut für Wirtschaftsprüfung und Steuerwesen" at the University of Hamburg, Max-Brauer-Allee 60, 22765 Hamburg, Germany, tel: +040-42838-6712, e-mail: freidank@mba.uni-hamburg.de.*

** *Research assistant and doctoral student in the chair for "Revisions- und Treuhandwesen" at the University of Hamburg, Max-Brauer-Allee 60, 22765 Hamburg, Germany, tel: +040-42838-6710, e-mail: patrick.velte@uni-hamburg.de.*

1. Introduction

Under the term of corporate governance, reform approaches, primarily from a legal point of view, will be discussed and transformed into standards, in order for capital market orientated companies to be managed more efficiently and to be controlled more effectively. In the dual system of German corporate governance, corporate governance in public limited companies is primarily aimed at the rights and responsibilities of the management board, supervisory board and shareholder's meeting, which, as main entities, sustain the target-oriented management and controlling of the company. However, also in the Anglo-American monistic system, corporate governance has a central significance. The bundling of management and control tasks for inside and outside directors based on the board system admittedly provides a flexible allocation of powers and responsibilities, however, at the same time, contains risks with reference to the neutrality of controlling. The fact that neither the monistic nor dualistic model can be referred to as being an absolute supremacy has induced the European Commission to implement a company voting right between a dual and board system when introducing a European public limited company.

This article is based on the interdependent relationship between corporate governance and controlling. The regulation tightness has also distinctly increased with regard to capital market regulation over the past few years, mainly attributable to internationalisation ambitions in the area of financial accounting and business reporting. Here an

intensification of controlling by corporate management in particular is to the fore, which, alongside internal instances (internal auditing, supervisory board), is carried out by external control bearers (annual auditors, enforcement, market for corporate control).

In the second chapter the essay initially covers a theoretical funding of corporate governance, as well as an explanation as to why there is a necessity to implement a business reporting system. In view of the fact that corporate governance substantially determines the embodiment of controlling by companies, the question arises as to what the concrete effects from the corporate governance discussion are on the controlling practice of listed public limited companies. In the third chapter the areas of auditing, supervision and control will be analysed separately, in order to clarify how the role of corporate governance from the point of view of management theory and practice presently depicts itself, and in what shape they need to be in order adjust to future developments. Furthermore, the basic influences on corporate controlling will be presented using the examples of intangible assets and long-term production orders according to IFRS. The article concludes with a summary of the findings.

2. Overcoming legal form-specific conflicts by corporate governance

2.1. Theoretical funding

The separation of company property and the authority to dispose of companies highlights the necessity of

corporate governance. The conflicts discussed under the term of corporate governance possess therein its core reason that the owner does not see its objectives represented in the acts of (employed) management. It shows that these controversial discussions can definitely reflect the behaviours in the company. In any case, the discussion about the improvement of corporate governance has its roots in the social, and especially the economic development of the USA.

The term corporate governance constitutes an analogy to the term of public governance, just like the connection the term corporate voting has with the term of political voting. In this context the question according to Becht et al. (2002) is posed, as to how representative a corporate government can be and who it should represent. Furthermore, it is interesting to what extent democratic behaviours are able to aspire and to what extent the privileges of individual owners should be limited. The aspects of corporate voting, the exercising of the authority to dispose by management, as well as the ways to corporate democracy are evaluated primarily in US-American literature, which are able to change the premise of a "One share, one vote" situation into a concentration of ownership and power.

The historic development of the US-American economy (and thus also society) features different models of governance. The term of corporate feudalism is summarised by Liefmann (1909) as the early voting trusts (owners transferred their shares to a trust in exchange for certificates) and the later holding companies in particular. The resulting (powers) owners were also named Captains of Industry. Later the managerial corporation with reference to the comments by Holmström and Kaplan (2003) pointed to the ideal of a company controlled by management. "Before 1980, corporate managements tended to think of themselves as representing not the shareholders, but rather 'the corporation'"¹. Because of the increasing number of shareholders, ownership and the authority to dispose fell apart. As a result of this, the US-American discussion on the corporate problem arose. Eventually the endeavours of the creation of shareholder democracy and minority representation, summarised since the 1960's under the heading of shareholder activism, could be interpreted as reform approaches, which are geared towards improving corporate governance.

Against this background, the US-American literature from the 1960s and 1970s investigated the question of how management, in the sense of the objective of the owner, can be disciplined. The most popular approach by Jensen and Meckling (1976) contains offering management incentives that exhibit the quality of the contract relationship. He finds the solutions in an optimal capital structure of the company. Today this theory of (incomplete) contracts still forms the starting point of the corporate

governance discussion. If owners and management were able to conclude a contract in advance, in which the regulations for all future possibilities are determined and which is free from transaction costs (Transaction Cost Theory), legal form specific problems could be avoided. All decisions would be made at the time of concluding the contract. In reality this does not seem possible due to the uncertain future development. The Theory of Contracts intensively analysed the thus incomplete contracts between principal and agent and therewith presented an important theoretical foundation for corporate governance. The latter referred to the question from Coase (1937), as to why hierarchical structured companies are formed in empiricism, especially as the prevailing opinion assumes supremacy of the market-based framework. Moreover, the theoretical deliberations on the allocation of disposal right (property rights theory) are referred to, which, according to the form of certain behavioural assumptions (human factors) and environmental factors (environmental factors) in the scope of controlling activity, cause costs. Another essential influence on the development of corporate governance assumes the theory of accounting policy ("creative accounting"), which in the Anglo-American area is conducted under the designation of earnings management.

At the same time existing information asymmetry between the principal and agent acquired in favour of the agent is of particular significance. Dissolving this, forming contracts and controlling is the answer prescribed by Watts and Zimmerman's (1986) Positive Accounting Theory, which continues to concentrate on external accounting. "Contracting literature suggests the hypothesis that accounting plays an important role both in contract terms and in monitoring those terms".² Even though the Positive Accounting Theory has been criticised numerous times, its input with regard to the pointing out of possible significances of accounting in the solving of contract and governance problems remains unchallenged.

With a view to the incomplete contracts of capital commitment and the existing information asymmetry it is the objective of corporate governance to protect shareholders' interests. Corporate governance, at the same time, means the targeted management and controlling of companies and includes mechanisms for regulating competencies, the creation of incentives, the installation of controlling processes and the coordination of the company's external relationships.

2.2. Implementation of a business reporting system

The ambitions of the reform in the scope of corporate governance have substantially changed the controlling practice of companies. As a result of the increasing capital market orientation and globalisation of

¹ Holmström and Kaplan (2003), p. 5.

² Watts and Zimmerman (1986), p. 196.

companies, external accounting (financial accounting), according to Freidank (2000) is interpreted in a publicity policy that increases company value, which is shaped by a continual intensification of the communication relationship between corporate management and investors against the background of the successful implementation of an investor relations strategy. In the past, besides investor relations, creditor relations were strongly referred to, which concern the relationship management between corporate management and the finance providers. In literature, the (group) financial statement is also classified as a business card for the company, which takes up a central significance in public relations, whereby the publicity policy aims to make the specific corporate culture and thus the corporate identity transparent to the addressees of the financial statement.

The publication strategy, which has to be characterised as honest, corresponds to the concept of value reporting according to Labhart (1999), whose content can be simplified with the sentence "Do your best for the shareholder and speak about it". Furthermore the AKEU (2002a) points to the increasing importance of Internet publicity as a design instrument for the improvement of investor relations. The increasing application of capital market-orientated corporate management concepts is the basic motive for a voluntary publication of information on the part of corporate management, which sometimes exceeds the traditional financial reporting. The essential objective of value reporting is the reduction of value gaps, which are formed between corporate management and the investor due to the asymmetrical information brokerage and the lack of capital market efficiency. The reduction of this should be caused by the strict compliance to the management approach. According to this, the external financial statement addressees will be equipped with the same information for the internal company control as the management.

Via obligatory reporting, value reporting provides relevant information for valuation purposes so that financial accounting analysts can have an improved idea as to the estimation of the company's value. Taking centre stage of the approach is every piece of information that, from the company's view, has an influence on the value of the company. In connection to this, the change of reporting from the past-orientated financial accounting to the comprehensive future-related business reporting is seen as indispensable. Alongside capital market oriented data, which allows an assessment of the company's value performance, value reporting also includes, according to recommendations by the AKEU (2002a), information concerning the company value not listed on the balance sheet and information regarding strategy and management performance, in order to provide the investors with a transparent depiction of the economic situation of the company. However, the information transported by value

reporting can only then bear reliable character for external financial statement addressees, if they are also subject to an inspection by annual auditors. Potential investors are thus put in the position to make their investment decisions on the basis of increased, improved and safer (i.e. checked) relevant company information for decision making. Value reporting does not only symbolically stand for value-oriented additional reporting of the former values in the company on the balance sheet date, but it also contains further information about the assessment of future flow statements.

Value reporting and corporate governance can, in this respect, be seen as aligned, as in they are aligned towards the superior corporate objective, i.e. the winning of new investors and the strengthening of existing shareholders' trust. In order to counteract the danger of the management having to bear difficult objectifiable value, general principles have been formulated to fulfil these information requirements. A positive effect of value reporting on the financial statement addressees is achieved, for example, in the scope of the description of the corporate measures in the area of environment protection, if the company is successful in credibly showing that it admits social responsibility. Since management's salary is more and more frequently linked to the company's performance on the stock exchange, the management board frequently also follows the individual political objective of an increase of the market value. In this sense a cadence between individual and financial policy objectives can be achieved by value reporting. Apart from shareholders, also all of the target groups are available as addressees of value reporting (stakeholders), and who are interested in the existence and the assurance of potential success for the company, e.g. employees, the exchequer, creditors and customers.

Value reporting can be used as a management instrument, to influence the choice behaviour of the addressees through a voluntary disclosure of the legal minimum, because the data submitted is only completely checkable and objectifiable by the external addressees of the financial reporting in the rarest cases. The current reform measures for corporate governance accounts for this fact, in which it increases the reliability of the financial reporting information. Information about strategy and management performance (so-called performance measurement) as a pillar of value reporting is expressed in the company practice by using dynamic figures, such as Earnings Before Interest and Taxes (EBIT) or Net Operating Profit After Tax (NOPAT). The management's target is to allow an accurate quantification of the market value of the company performance by means of an external report of these performance indicators (so-called performance reporting). It behaves similarly to details of non-balance sheet values in a company, e.g. self-provided intangible assets of fixed assets which, according to national GAAP ("Handelsgesetzbuch" (HGB)) and

international financial reporting standards (IFRS), can solely be accounted for in the balance sheet in a restrictive form. When finding the value stated for each item, the management has no negligible discretionary powers, especially if the value has to be estimated due to a missing sales market. As an example, the difficulty of value finding for the human capital stock comes to mind.

At the same time, more and more legal norms impact on the company and are most notably traced back to upheavals in corporate governance. The legal norms penetrate the company sphere via specific "incident paths", which are represented in the controlling approach hypothesis by the elements of control, inspection and supervision. Control as – differentiating from investigation and supervision – a process-dependent control operation also integrates controlling alongside housekeeping measures of protection. Apart from these controlling measures the comprehensive corporate control system also contains external investigation as well as supervision.

3. Analysis of legal norms of Corporate Governance

3.1. Audit-orientated influences

In the scope of the different varieties of company-related examinations, external auditing of financial accounting corresponds most notably to an outstanding significance because of its public benefit. Established as an academic discipline in Germany, most notably by Schmalenbach, auditing teaching initially dealt with the practical separate questions of different auditing functions, then with auditing company institution and, according to Ewert (2002), continues to look for a complete auditing theory. In practice, the implementation of accounting regulation in the scope of the reform efforts for the improvement of corporate governance has been strengthened again, which according to the AKEU (2002b) enforcement, which predominantly acts preventative and corrective and thus should induce a quality increase of financial reporting, remains the focus.

Within the scope of annual auditing in accordance with § 316 f. HGB, financial accounting, i.e. the annual report as well as the status report, constitutes the essential auditing object. In groups this is valid for the group financial statement as well as the group status report. Furthermore, bookkeeping, cost accounting, as far as it provides information for the valuation of assets, and the internal control system are the auditing objects of the annual audit. In addition there is a duty to audit for the IFRS individual financial statement, provided that this is created voluntarily and disclosed in accordance with the HGB. For stock exchange listed public limited companies the risk management system has to be likewise checked according to § 317 HGB. In the course of the efforts to improve corporate governance,

financial reporting standards are exactly set out like the regulations for the annual audit amendments.

It is thus worth questioning, to what extent the legal norms in the field of financial accounting and annual auditing effect controlling, whereby in the following only those areas, which have become essentially important for the internal control of the company via the current reform upheavals, are addressed.

Through the EU-IFRS regulation, European capital market-orientated parent companies have, since January 2005, basically been bound to compile a consolidated financial statement according to International Financial Reporting Standards (IFRS). According to Kirsch and Steinhauer (2003) this implies that the IFRS will prevail as the worldwide accepted financial accounting standard.

For non-capital market orientated companies the EU regulation includes a member state electoral law. The national legislator has passed along this option as a company electoral law. Furthermore the HGB provides a right to vote for the individual financial statement of not only capital market-orientated companies but also all of the remaining companies regarding the production of this for the purpose of information also according to IFRS.

Across the board, financial accounting according to IFRS is considered more suitable than financial accounting according to HGB norms, due to the information provision of the addressees. Finally the information brokerage relevant for decision making (decision usefulness) constitutes the overriding objective of IFRS financial accounting, while national reporting procedure for the individual financial statement has to meet the task of profit distribution and tax assessment alongside the information function. Arising from this are essential discrepancies in the weighting of the accounting principles (in particular above the line income statement versus the dominance of the principle of prudence). The conflict between both targets experience, however, according to Coenberg (2000), a certain relativisation due to the underlying objectified accounting principles of IFRS financial accounting. The information relevant for decision making from the IFRS financial statement should simplify the preparation of forecasts for the addressees (mainly regarding the company's future payment surpluses) and corporate decision making (fair presentation). As a result of this, it follows that an IFRS financial statement actually corresponds to the objectives and tasks of the management, rather than a HGB financial statement. IFRS financial accounting makes the following essential high demands on controlling:

- The accounting of intangible assets according to IAS 38 clarifies how the future corporate use of this asset criterion is for its approach and valuation in the balance sheet. When discriminating between research and development expenses, R&D controlling can be fallen back on.

- In the scope of the accounting of (long-term) production orders according to IAS 11 the Percentage of Completion Method (PoCM) is to take priority. The required existence of an extended cost calculation, as well as the requirement of a reliable determination of the degree of completion in the project cost centres formed falls into the domain of project controlling.

All in all, numerous pieces of information from controlling are necessary for the IFRS financial statement. Alongside past (actual) figures, future forecasted figures also amount to an increasing significance, especially due to the consideration of the future corporate benefit and the identification of opportunities and risks of future performance. This is especially also valid, according to the HGB, for the variety of pieces of (group) status report information that are related to the results of corporate planning. The (group) status report is viewed in this light as an interface between financial accounting, management accounting and business reporting.

Apart from the demands that are increasingly made on controlling on the part of financial accounting, this is itself, in the scope of an assessment according to the HGB, an object of commercial law. On revision of risk reporting, the annual auditor has to provide an impression of the quality of the internal reporting structure, in particular the adequacy and the effectiveness of the risk and opportunities management system is to be critically acknowledged. Additional value-orientated company information, which is disclosed outside of the obligatory auditing part of the annual report, is already presently an indirect element of obligatory auditing, as financial accounting and value reporting have to be harmonised. Moreover, a voluntary auditing of value reporting in line with the implementation of an auditing review is to be considered in order to give the annual report a higher significance versus the capital market players.

3.2. Supervisory orientated influences

The supervisory board oversees the original managerial functions of the executive board in the German corporate governance system according to the "Aktengesetz" (AktG). The function of the supervisory board should involve advising the executive board on general corporate management questions and bear the character of preventive, future-orientated surveillance. The consequence according to Scheffler (2003) is that pure past-related supervision is not sufficient. Thereby the duty resides with the supervisory board to also oversee controlling across its ordinal, legal, purposeful and operating efficiency. For these purposes it may not basically use the internal auditing, which, as a rule, is subject to the executive board's instruction in the German system of corporate governance as a staff position, and which is exclusively reported to them. However, the supervisory board can, in the scope of its duties of

overseeing the risk management system, call on, when required, specialists and informants to give advice in the supervisory board meeting (§ 109 AktG), whereby company and group employees may be drawn on only on placement by the executive board.

In view of the supervision of the risk management system, the head of controlling as well as the head of internal auditing or accounting can be asked here. A duty which calls on this in the scope of supervision of the risk management system can only be relevant when there is ascertained defects in the regular report (§ 90 AktG), or when there is the existence of doubt in the adequate and orderly reporting of the executive board. With this right, the supervisory board should – even when the significance of risk management is so high – be very careful. This is to avoid making a false impression on the internal experts – here the head of (group) controlling. It would represent mistrust against the executive board, which is why it is recommended summon the informant via the executive board.

A strengthening of the supervision activity or corporate governance should be generated in connection to this by the formation of special committees. In corporate practice these include, among others, Nominating Committees, Compensation Committees, and Disclosure Committees as well Audit Committees. This specialisation of supervisory organs within corporate governance, originally intended for the monistic corporate charter, enjoy growing popularity in the dual system. Here the independence of the surveillance bearer, like in the board model, is less to the fore than the increase in effectiveness of daily supervisory activities.

However, the supervisory board can only sufficiently fulfil its supervisory duties when it, according to Theisen (2003), is supplied with corresponding information by the executive board. § 90 AktG governs in detail the ordinary and extraordinary reporting commitments of the executive board which have to be fulfilled vis-à-vis the supervisory board. § 90 AktG in particular provides that fundamental questions about company planning (in particular about financial, investment and personnel planning) as well as variations of the actual performance against the previously reported objectives stating the reasons why underlie the reporting commitment of the executive board. Furthermore, the supervisory board has to be briefed on the profitability, revenue and the situation of the company according to § 90 AktG.

Such provision of information as an active responsibility of the executive board requires the existence of a comprehensive controlling system, from which the required planning, control and supervision data can be gathered. Thus the company's strategic and operating goals, the implementation measures and finally corporate planning, inclusive of implemented control systems, are the important building blocks of future orientated supervision by the

supervisory board. Hereby traditional function areas of controlling are addressed so that the controller provides essential reporting content to the supervisory board. Consequently, the reporting commitment of § 90 AktG influences controlling, whereby its reporting has to be aligned to the specific requirements of the company addressees.

In recent times the aforementioned addressed value-orientated control concepts and the communication of (selected) key figures have increasingly gained in importance, particularly in listed companies. The aim of value-oriented reporting is the reduction of information asymmetry between investors and management, as well as the accompanying avoidance of value gaps in the capital market. Because of the developments in the areas of value reporting and as a result of the supervisory board's supervision duties of the legally established reporting commitment for management, the supervisory board has, according to Ewert (2006), been enabled to be in a position to assess the performance of the executive board with a view to increasing the value of the company. The corresponding value-orientated control system provides controlling.

A contribution for improving corporate governance, as well as an exculpation possibility for those responsible, can, thus, lie in the preparation of decisive documents to support management via controlling. This is also valid in respect of the executive board's reporting to the supervisory board.

3.3. Control-orientated influences

3.3.1. Essentials

In the corporate governance discussion the charter has prevailed, resulting in an essential contribution for avoiding corporate crises coming from internal early warning risk systems and the checking of internal auditing, flanked by external auditing measures. New research works (including Freidank and Paetzmann 2003) in proportion to corporate governance and controlling emphasise the central contribution of controlling in the targeted management and supervision of companies. If it is an advantage of the controlling systems vis-à-vis the external accounting, the supervisory board and the external auditors, without being able to work in the statutory framework, in order to be able to adjust more flexible and quicker to environmental changes, then it remains open nevertheless, as to how far legal norms act/impact on controlling and internal and external reporting. External accounting that supports legal norms is not traditionally the controller's domain. His field of activity refers to, among other things, the decision-orientated internal accounting. It is worth noting that both of these basis systems, influenced by worldwide attempts at harmonisation, are converging stronger and stronger, whereby international accounting norms also exert increased influence on controlling.

In the following text, the requirements, which place external accounting norms on the configuration of the controlling and business reporting system, are investigated in more detail using the examples of intangible assets according to IAS 38 and long-term manufacturing orders according to IAS 11.

3.3.2. Intangible assets (IAS 38)

It is to be noted that elements of financial accounting are used more and more for management accounting. According to Kahle (2003) this is particularly valid in view of global mega corporations, which use internal management measurement tools for the raising of international capital and also for the communication to (potential) investors, and for which the coexistence of internal and external accounting is not the intended result. Insofar, cost advantages are argued as the reason for this development. By using elements from the IFRS for internal control purposes, legal norms work towards convergence between internal and external accounting. The effects of legal norms develop further, when incentives for management authorities are linked to the achievement of certain figures provided by external accounting bodies (e.g. profitability figures based on annual report data). In this case, the norm sizes of the financial reporting have effects on the control behaviour of the company. The trend towards information societies and the progressive technical development allows the total value of the company's intangible assets values to continually increase according to the opinion of the AKIW (2003). They outline strategic company drivers because of their important operating significance. Provided that intangible assets cannot be considered appropriate, *ceteris paribus* the company's opportunities and risks can only be insufficiently estimated due to external financial statement addressees, whereby there is a value gap in the capital market. Due to the fact that self-provided intangible assets are difficult to quantify, margins of discretion emerge as a rule, which have to principally lead to a non-activation following the strict compliance of the principle of prudence.

In contrast to national financial accounting, no general statement ban for self-created intangible fixed assets according to IAS 38 is basically assumed. An essential assumption is found in IAS 38.63, which, among others, invariably prohibits the approach of self-creating brands, since as a rule no active market can be assumed within the meaning of IAS 38.78. Forasmuch, the commercial law requirement of IFRS of a valuable acquisition is in principle inferior. The discrimination of intangible assets can, among other things, be traced back to the secondary significance of the principle of prudence of international financial accounting. Instead, an urgent approach is necessary, if the asset possesses the abstract and the concrete financial accounting ability. The asset has to be clearly identifiable as an insubstantial resource, bring about a future commercial use and be in the power or

under the control of the company. IAS 38.21 requires that for a concrete approach to the intangible asset, its acquisition and manufacturing costs are to be determined and an advantageous inflow is to be expected with high probability.

The lacking objectivity of the abovementioned approach requirements has prompted the International Accounting Standards Board (IASB) to demand a division of the company's manufacturing process in a research and development phase for all self-created intangibles. If a division of the costs in the abovementioned phases is not possible, all costs according to IAS 38.53 are to be considered as recordable expenses. This again underlies the fundamental significance of a harmonised internal and external reporting system and controlling function. The search for new scientific or technological findings in the research phase is in line with IAS 38.8. The applications allocated to this phase are subject to a general activation ban. The development phase encompasses the activities following the research, which are applied to a plan or a design for later production in the research results or other knowledge, e.g. the creation of prototypes or the testing of new materials. Expenses arising from the development phase are mandatory to bear fruits, if the conditions named in IAS 38.57 are cumulatively available. The requirements are the technical feasibility of production, the intent and ability of completion and application and the later sale of the asset, the documentation of the future profit potential through the evidence of an active market, the availability of technical and financial resources to the successful completion of the development phase, as well as the ability to reliably value the arising expenses. These condition statement requirements have to be provided by the internal management control, otherwise an activation of the corresponding development expenditure does not come into consideration.

In the scope of value-orientated management control according to Velte (2006a) intangible asset reporting should be extended as follows:

- Strict concentration on the management approach. This concept has become particularly important with regard to the question of a convergence between internal and external financial reporting (integrated accounting). It is aimed at aligning external corporate reporting to internal management control. The external addressees should be allowed an insight into the perspective of corporate management. The aim is to reduce the existing information asymmetry between management and the financial reporting addressee.
- The interpretation of the reduction and process of internal management control with the aid of suitable key figures. This method is likewise traced back to the concept of the management approach. On application of the shareholder value principle and the value based management approach respectively an increased transparency of company procedures can be achieved. Furthermore, possible weak spots in the

implementation of the corporate overriding goal of market value maximisation of equity can be recognised early and eliminated.

- A group's intangible assets should, independent of whether they are built into the balance sheet or not, be subject to reporting. This includes self-created intangible assets, e.g. human capital, customer relationships and location factors.
- Research and development activities are presented under the deployment of appropriate key figures. The research rate as a ratio of research expenditure to revenue, or the research efficiency as new a new product rate are examples of expressed benchmarks.

Up to now corporate reporting has limited itself as a rule to a pure verbal representation. The recommendation of stating key figures serves the objective of a strengthened quantification of the research and development activities and the improvement of corporate governance.

In light of the fact that a general option ban for a large part of the original intangible asset is to be also noted in the scope of IFRS financial reporting according to IAS 38.63, 38.48 (e.g. for the original goodwill, original brands, client lists or publishing rights), it results in the market and the company value respectively being presented as unfounded. The resulting value gap from this can finally be concluded with the help of additional communication instruments. In the meantime an abundance of proposals are available for the reporting and controlling of intangibles, e.g. the creation of an intellectual property or capital statement, a knowledge or technology balance sheet or the implementation of a reporting scorecard. A successful example is illustrated in addition by the so-called Skandia Navigator of the Swedish insurance company with the same name.

3.3.3. Long term manufacturing contracts (IAS 11)

The range of topics surrounding the contract manufacturing of unfinished goods has of late gained an increasing value-related growth in significance due to the progressing technologisation, specialisation and internationalisation of commercial happenings in various industries, including ship building, plant and aircraft manufacturing and the research and development industry, and frequently represents the emphasis of the company. The additional long-term contract manufacturing basically points to manufacturing processes that include at least two business periods, i.e. conclusion of contract and making delivery deadlines in various accounting periods. Furthermore, a limited number of finished assets and a complexity and exclusivity of the finished product is implied. In addition, according to Freidank and Velte (2007), after manufacturing a customer-specific plan and development has to be foregone.

Despite the fact that there is no application risk from the concluded manufacturing contracts for the manufacturing company, the area of long-term contract manufacturing is characterised by an increased complexity and sensitivity to risks. In the course of this, cost risks largely play a decisive role in this and can be separated into cost type risks and cost level risks. Long-term manufacturing contracts are, in contrary to serial production, characterised by a high degree of individuality in the product design, so that a strong dependency on the order is present. They represent piece production in this way and can, as a rule, not be repeatedly created. On calculating the costs at the start of the project, substantial problems exist when quantifying and considering all cost factors, since recourse not only to industry or company comparisons, but also to earlier production contracts of the regarded manufacturing company, in light of the exclusivity of the order, is only possible within narrow bounds. In addition, technical risks when defaulting or misperforming play, among other things, a considerable role (including in the shape of possible conventional penalties or lawsuits), if the compliance to certain performance indicators or deadlines are guaranteed in the contract, and emphasised during the course of the production time, if these cannot be fulfilled by the manufacturing company. Finally, financing risks could likewise appear, possibly arising from a potential non-payment or payment default by the orderer. A prior correct financial rating of the client by the contractor in the sense of undertaking a rating process itself or via a rating agency thus seems to be desperately required. If the creation of a product is successful over a period of several years and a legally binding order between the contracting parties is concluded, the question of the period of revenue and earnings realisation again arises.

The image of long-term manufacturing contracts is closely connected to the question of the interpretation of the realisation principle, according to Pottgießer et al. (2005). According to F 92 f. in connection with IAS 1.13, applications and earnings are then realised when a decrease and increase respectively of the commercial advantage for the company is recorded and which can be reliably procured. The condition statement requirement of the final transfer of risk as a realisation period does not possess any relevance in the mapping of manufacturing contracts in IFRS financial reporting. Instead we must assume a continual accumulation of success during the provision of the service, in terms of a moderate interpretation of the realisation principle for the benefit of the principle of the above the line profit assessment on the reporting date.

Should a reliable estimate of the order results be given, the order revenue as well as the order costs corresponding to the performance progress on the reporting date are to be considered in the P&L as earnings and applications. This accounting concept is characterised in IAS 11.25 as profit realisation

according to the degree of completion and performance progress respectively. Due to the monofunctional arrangement of IFRS in the information requirements of the financial statement addressees, it is regularly presumed in this context that the PoCM concedes information useful for decision making to the degree of the performance on the valuation date and, in comparison to the profit realisation at the end of the manufacturing contract, a positive effect is exerted on the company's corporate governance, because it should rather correspond to the actual condition of the company.

On the other hand, IAS 11.22 in connection with IAS 11.36 demands an immediate anticipation towards expecting losses from the manufacturing contract. As total costs should probably exceed revenues, an income statement-related consideration of the expected losses will follow in full as expenditure in the P&L in the effective reporting period.

The unlimited application of PoCM depends on the required condition statement of the reliable estimate of the orders' earnings. If this condition cannot be fulfilled, IAS 11.32 stipulates a limited revenue realisation up to the amount of the previously incurred contract costs. This method is characterised as a so-called shortened or modified PoCM, as in this respect, a profit statement of zero is assumed (zero profit margin).

A corporate policy orientated towards shareholder value will basically vote to undertake a realisation of partial profit before the end of the contract, since this generates, according to Papst (2006), a positive signal effect *ceteris paribus* (signalling theory) with regard to the future distribution policy for the (equity) investors, and facilitates a realistic valuation of the operating conditions. In this sense Velte (2006b) qualifies PoCM as the instrument for value-based management, which aims at a strengthening of investor relations and an explanation of the value gaps between the market and book value of the company before the completion of the manufacturing contract. The reduction of information asymmetries and the strengthening of shareholder trust is, at the same time, an essential matter of the internationally-led discussion about "good" corporate governance.

The IASB assumes that a reliable estimate of the contract earnings is only guaranteed by the establishment of an effective internal budgeting and reporting system. Equally, an effective controlling function is presumed. An immediate contract calculation is necessary for the purposes of cost planning directly after the conclusion of the contract, which considers all of the orderer's performance and product requirements. At the same time, the manufacturing contract is to be broken up into its individual units; the individual units are allocated to individual budgets. A reliable estimate of the respective project progress on the reporting date is only guaranteed by an immediate contract calculation,

in order to take all costs or time deviations into consideration in a timely manner. In addition, the instrument of deviation analysis is frequently fallen back on in the operating practice, which carries out a detailed investigation of the variance causes on the future project progress.

A central significance is attached to the internal management control when processing long-term manufacturing contracts according to IAS 11. A recently discussed and feasible method is presented by Niemand (2005) as the Earned Value Method, which is complemented by a market-orientated method, such as target costing. The traditional budgeting systems can, in the prevailing opinion, not or only insufficiently fulfil the large-scale requirements that are placed on the accounting considerations of long-term manufacturing contracts according to IAS 11. The efficiency of the internal reporting structures and controlling determines the application of the PoCM, which presumes a reliable valuation of the contract earnings. Alternatively a partial profit realisation of the production of the order is – as already explained – unacceptable when complying with the (unattractive) zero profit margin.

4. Conclusion

Corporate governance covers all of the issues concerning the efficient management and controlling of companies. Controlling supports and complements the surveillance activity in the dual and board system, as long as the management approach is followed and the existing information asymmetries between corporate management and investors are dismantled. The explanations clarify that internationalisation efforts provide a decision making process for corporate management, in which they demand target-orientated control and supervision (so-called harmonisation of the internal and external reporting module). For this reason the requirements of the capital market for value based management and the connecting factors for the strengthening of corporate governance complement each other.

The internationalisation efforts towards controlling are gaining weight due to the current corporate governance discussion. Using the example of intangible assets and long-term manufacturing contracts according to IFRS, it was featured that both a harmonised internal and external financial reporting and an effectively organised business reporting is already obligatory for financial accounting crossing over to IFRS. Furthermore, these tendencies are accelerated by the increasing need by all internal and external coalition participants for company value-orientated corporate information. In this respect, the implementation of a shareholder value-guided corporate policy and the accompanied offensive publicity conduct by management does not only strongly influence corporate governance; this results in a further essential impulse for a future standardisation of value reporting and controlling, in

order to contribute to a higher timely and inter-company comparability of company information.

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