

## **Theoretical Perspectives in Financial Statement Knowledge for Managers Pursuing Net Income**

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*Journal of Functional Education; Fall 2007; Vol. 1, No. 2; Emmanuel University Journals, pg. 23*

### **RESEARCH ARTICLE**

## **Theoretical Perspectives in Financial Statement Knowledge for Managers Pursuing Net Income**

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### *Abstract*

Some department level managers pay attention to their corporation's net income. Possibilities of encountering distracted managers who lose focus of their corporation's financial goals also exist. Such possibilities would necessitate creativity in designing solutions. Possibilities also exist of encountering focused managers who maintain consistency in mode of operation on their jobs. The possible availability of these two groups of managers within the pool of corporate operators provides a window for observers to peep into the world of department level managers in the context of financial level knowledge side by side with net income pursuit.

### Introduction

Balance sheet, cash flow statement and income statements are the flagship documents that contain high level accounting records for a broad picture of any organization. Koenig (2004) states, "understanding the big three—balance sheet, profit or loss statement, and cash-flow statement—will whet your appetite to learn more" (p. 12). In order to successfully deal with the topic of the intended investigation, two variables stood out. They are *knowledge of financial statements* and *the corporation's net income*. It also became clear that the department level manager stood in the middle, while the study sought ways and means to confirm whether or not his or her increased knowledge of financial statements was related to the net income of the corporation. Those two variables compelled the review of literature to explore three major aspects of the study. The first one deals with the types and amount of financial knowledge involved in publications. The second one deals with the act of examining financial statements. The last aspect deals with circumstances surrounding a manager's knowledge of financial statements.

In the first instance, it became clear that finance and accounting rules and regulations mattered immensely. It was also noticed that some managers sought knowledge because it made them look good and eligible for higher wages. Such income driven knowledge created increased curiosity in how much financial knowledge was applied at work, how knowledge base was identified, how the managers and their corporations achieved net income, and the relevance of that knowledge to the managers. Shareholder well being turned out to draw increased attention, as a manager that did not know about shareholder well being could only emphasize job versus career or profession.

In the second instance, examining financial statements became prominent because literature appeared to wonder whether the managers even spared time to examine the Balance Sheet, Cash Flow Statement, and Income Statement. The criticality of this instance led to the pursuit of resources for determining extents of examining the statements, extents to which financial knowledge need is recognized, and the managers' breadth of personal knowledge in the area of finance.

Finally, some patterns that emerged drew major attention to scenarios of management knowledge in which some importance was attached to a manager's ability to add value to the corporation. Such value added on the net income would also become crucial. The manager's challenge to become and remain responsible and accountable added the components of consciousness, good personal citizenship, and excellent professional behavior to the list of requirements for an ethical conduct of the manager's business.

With all above curiosity in the search of pertinent scholarly work, research studies pointed in directions that elucidated the subject of the intended investigation. The studies that stood out the most are reviewed hereinafter, with the intention of finding bases for deeper understanding of the subject matter.

### Types and Amount of Finance Knowledge

### *Knowledge of Rules and Regulations*

Knowledge of rules and regulations in this subject area draws attention to Sarbanes-Oxley Act of 2002. It featured in a research study in which Frieswick (2005) reports, "31 percent of public-company CFOs said that before the passage of the Sarbanes-Oxley Act in 2002, their CEOs might have been ignorant of major financial fraud in their companies" (p. 9). Whether such a situation was for purposes of alibi or that the level of CEO's knowledge of financial activities was truly low remains unclear. Either way, this post-ENRON Act has shown that whether real or faked, ignorance of financial activities, recording, and reporting plays important roles in the life of an organization. Frieswick encapsulates that ignorance in the perception held by CFOs regarding their CEOs' level of involvement (knowledge) in transactions gone bad. He reports finally that only 49% of CFOs state that CEOs are not ignorant of the goings-on in the financial life of their corporations. In the study, Frieswick (2005) reports that 20% were unsure of the CEO's level of awareness.

In a personal testimony reported by the research, the chairman and CEO of an automobile company ran his corporation for nearly 10 years without any knowledge of finance. The man's confession, according to Frieswick (2005) states,

We were in a meeting, and I couldn't follow some of the detailed financial and balance-sheet discussion. I [couldn't figure out] what should be done because I couldn't understand the issues. Realizing that his ignorance put him at a disadvantage, Jackson went back to school to study accounting and finance. (Frieswick, 2005)

The automobile company chief confessed that he had gained a full understanding of the financial principles and metrics that most affect his company. Frieswick's research study is a tool for navigating the world of company top executives. The confession made by the researched CEO points to the correlation between his knowledge of financial principles and the success of his company.

Another research by Howlett, Kees and Kemp (2008) found support in Kozup, Pagano, and Greyer (in press) stating "Beyond important "psychological" variables such as self-regulation and consideration of future consequences (CFC), basic financial knowledge is a critical factor in financial decision making" (p. 7). For further substantiation of the argument, Howlett et al. (2008) cited Perry and Morris (2005) and Lusardi and Michelle's (2007) works stating that focused financial knowledge when making financial decisions is consistent with prior studies that have demonstrated the positive role of financial education in financial planning behavior. All these arguments push a strong case for knowledge of financial statements as a catalyst to a corporately sensible financial behavior, which a manager could also use for self-regulation.

Howlett et al. (2008) concluded their support for the argument by drawing attention to results from Fox, Bartholomae, and Lee (2005) stating that they shared the same findings in both studies, which held that financial knowledge influenced financial decision making, and that financial literacy involved one's understanding and knowledge of financial concepts and its imperativeness for effective consumer financial decision making, whether as consumers or suppliers (Howlett et al., 2008). These findings, according to Howlett et al. (2008), reinforce the importance of sound financial knowledge, which is the core of this overall research

Practitioners face a temptation to use accounting ratios as tools for answering the question for which this research is being conducted. Incidentally, Byard and Cebenoyan (2007) published the result of their research, revealing that "analysts' forecasts reflect an understanding of firms' operational efficiency based on information from firms' financial statements that is more sophisticated than simply examining firms' accounting ratios" (p. 451). This means that a manager's versatility in the ratios is not enough to prove that such a manager possesses enough knowledge to conceptualize, prepare and present forecasts. Their assertion is based upon the fact that using current accounting figures to project immediate and distant future will be more beneficial to a corporation than using ratios, so long as a manager operates within the boundaries of the generally accepted accounting principles.

Fogarty, Graham and Schubert (2007) said,

Some sensitive issues that require the auditor to assess the severity of any deficiency include inadequate documentation of the components of internal control; employees who lack the qualifications to fulfill their assigned functions, which include making the required GAAP accounting computations, accruals or estimates; preparing the company financial statements. (p. 64)

The above research study was conducted in order to find out the extent to which corporations adhered to

accounting rules. Among other things, the researchers found that the type and amount of knowledge to be possessed by managers varied. They did not identify a pattern. Therefore the basis on which the corporations hired managers was not ascribable to a specific paradigm. It means that managers of public corporations have varied types and levels of knowledge in different educational areas. Since the extent to which a manager should possess knowledge of financial statement in order to contribute positively to the corporation's net income remained unclear after incisive consideration of Fogarty, Graham and Schubert's (2007) research, assumptions such as have been presented began to be made.

### *Income Driven Knowledge*

According to Widding (2005), a company can achieve competitive advantage if it has in its warchest the elements of product knowledge, market knowledge, organizational knowledge and finance knowledge" (p. 8). He explained that those elements are contributors, but all come under one group referred to as business knowledge.

He chose to view the manager as an entrepreneur who should do whatever it took to keep his 'organization' healthy in all ways. As an entrepreneur, the manager would not wait for the CFO or CEO to identify for him or her the steps necessary for the department to contribute effectively and efficiently to the corporation. Widding (2005) states, "Within "finance knowledge", there are three subcategories, namely, knowledge related to funding, internal finance management and tax planning" (p. 10). If a company would do what Widding (2005) says and for the reason provided, then Lusardi and Mitchell (2007) must be right in stating that "Kimball and Shumway (2006) report a large positive correlation between financial sophistication and portfolio choice" (p. 7). That sophistication consequently arises from an individual's knowledge of the corporation's products, markets, organizations and finance.

*Finance knowledge application at work.* Nelson, Gorman and Jacobson (2004), in their revenue recognition research discovered, "In sum, the consequences of improper revenue cognition in corporate financial statements can be catastrophic. Courts have found that corporate financial statements that improperly recognize revenue and fail to conform to GAAP constitute presumptive false and misleading statements" (p. 294). This means that managers should keep accurate monetary records. Ample support for a firm-wide review of financial statements by department level managers thus exists and is supported by scholars.

Streeter's (2007) research states, "surveys suggest that Americans lack basic financial knowledge about how to successfully manage debt" (p. 11). This apparent blanket statement sets the stage for an understanding of the population from which the corporations recruit their department managers. Streeter (2007) explains that due to lack of financial knowledge, people could be deliberately misled with false information, coercive advertisements and sales practices. If the United States corporations are hiring their managers from among a population made up of financially illiterate but generally educated individuals, then their corporations or departments led by such individuals may be misled deliberately or otherwise into making the wrong financial decisions thereby plunging their corporations into a low or negative net income altogether. He concludes that such managers will be unable to apply finance knowledge at work because they do not possess it.

In a research study, Wallace's (1997) found a gap that represented managers' lack of grasp of bookkeeping entries, and asked, "Where are the debits and credits?" (p. 229). This means that accounting records do not reflect accurate display of entries. The situation warrants that department level managers must be equipped to complement the roles of internal auditors by pre-auditing their immediate organizational sub-domains, knowing that internal auditors will come behind them to review the records. Furthermore, external auditors will also come to do the same thing, which means that a self-installed first-layer audit will go a long way to contributing to the net income as well as making shareholders safe. This is possible through a concerted effort in learning the applicable financial topics and nuances necessary for the job tasks. This helps to make the managers relevant. It will also transform the organization into a learning organization with positive social or intellectual capital. This trend can be likened to building quality into a product before it reaches the quality control or quality assurance section. Wallace's (1997) assertion identifies a need to have knowledge that can be applied at work.

*Knowledge base identification.* Mandell and Klein (2007) conducted a research study in which young adults and up to company executives across the United States were surveyed on the subject of financial knowledge. They discovered, "Despite the importance of financial literacy, surveys demonstrate that American youth and adults do not possess the basic knowledge needed to make good financial choices" (p. 8). This discovery, made during the middle of 2007, preceded Streeter's (2007) finding, "surveys suggest that Americans lack basic financial knowledge about how to successfully manage debt" (p. 32). Both studies refer to surveys, but Mandell and Klein specify five successive national surveys that formed part of academic research. Mandell and Klein's (2007) research in the summer of that year and Streeter's (2007) in the fall of the same year appear to corroborate their findings with prior research. It is,

therefore, highly probable that current level of financial knowledge among department level managers is not as high as it ought to be for the corporations to witness high net income. The intended investigation here would deploy its survey in order to elicit from individuals with experience as department level managers the role of financial knowledge at their level.

*Net income achievement.* Block and Hirt (2005) emphasize, “not all firms would choose to operate at a high degree of operating leverage” (p. 105). Therefore, a manager, irrespective of his or her relationship with finance and accounting, should be able to understand the organization’s financial direction. If, in particular, he or she understood how the company transacted on bonds, commercial papers, debt and equity, then he or she would successfully contribute to net income. If a bad handwriting is on the wall, he or she is also able to recognize it because of his or her level of understanding of financial statements. What the manager should be looking for is whatever moves the company along its intended financial direction. He or she can only look for what he or she knows about. Unfortunately, according to Albrecht et al. (2005), “most businesspeople never see a real trial balance during their entire business career” (p. 102). This means that there may be a gap in organizations created by lack of essential knowledge of financial statements.

A research study conducted by Biosvert (2006) covered a general area of development managers. That study finds that an organization will achieve its objectives more readily if it paid some attention to the quality of its managers. That quality pointed to knowledge acquisition. The knowledge included financial dimension as a priority. Based on his research findings, Biosvert (2006) states, regarding the corporations that, “They must adopt an organizational structure that encourages all managers to act as if they have an ownership stake in the company” (p. 35). This means that a company should take steps to facilitate an increase in their managers’ levels of knowledge, with more focus on the financial. This, according to Biosvert (2006), will lead the corporation to the attainment of its profit objectives. Whether or not the companies are doing it will be left to a targeted investigation. If companies do it, the extent to which they do will also be left to research. The former is enough to attract this research. However, in the process of reviewing scholarly materials, it was noticed that the answer to the former would bring any study close enough to answering the latter. This investigation increased its curiosity about the latter, and decided to pursue the answer to it.

*Relevance of managers’ knowledge.* In emphasizing intellectual capital, Biosvert (2006) found out other ways to engender the increase. He also acknowledged the existence of efficient and inefficient managers. He recognized the existence of employee mindsets such as ‘job’ and ‘career’. He also noted that some managers are efficient and others are not. On the basis of those realizations, the study paid attention to managers, their careers and knowledge, advising companies thus:

They must offer their most efficient managers interesting career opportunities within the organization. They must make developing an integrated management information system that produces management information that integrates the financial dimension a priority, which will be useful and used by die functions. (Biosvert, 2006)

In the era of mergers and acquisitions, for example, department level managers can lose their jobs before they know it because of inability to interpret developments. When a company take-over is finalized in such transactions, managers who survive must know three very important perspectives that emerge when firms consolidate after a takeover. Managers must understand the proprietary view of the organization where the parent company pays more attention to the amount of its ownership of the subsidiary. Parent perspective exists in which a controlling body expects the owner to add the values of both entities and allocate just a part of the owned entity to it for control purposes while the owner controls the rest. The last is the perspective of the accounting standard boards requiring owner to combine everything and allocate proportionately to the two sides (Shortridge and Smith, 2007). Department level managers who do not know this fact may wonder in frustration what has befallen their company if such managers happen to be on the acquired side of the table. That alone is enough reason for morale to be low with regard to net profit. Otherwise, there will be a synergy arising from the cooperation of the merged companies. The above perspectives highlighted by Shortridge and Smith (2007) strengths on Widding’s (2005) essential “elements of product knowledge, market knowledge, organizational knowledge, and finance knowledge” (p. 8).

Creating and maintaining uniformity will apparently help organizations to remain relevant. Such help is found in unified interpretation of objectives and expectations, as a research study found that if all managers could see the same picture, a coherent application of knowledge would result. Dennis (1999), in searching for corporate reality for organizations, identifies assigning of monitors, analyzing of relevance, creating of awareness, gauging of impact and gaining of acceptance as important factors in keeping everyone on the same page. These antecedents produce corporate

move in one direction and ultimately result in the expected net income. Phillips, Luehlfing and Daily (2001) reveal, “controversy surrounded some companies because of their practice of recording revenue when they shipped inventory to dealers” (p. 46), which means that due diligence is required of all levels of management in recognizing and recording transactions. Department level management, however, has an unsung mediating function as the glue that holds the top and bottom of organization. The relevance of knowledge mandates that the said managers make sure revenue is properly recognized. Lack of necessary knowledge of financial statements may render management incompetent, thereby leading to violations that may affect their operatives below as well as their higher management.

### *Knowledge for Shareholder Well-being*

Corporations are formed in order to create value for the individuals who formed them. Publicly traded companies have shareholders whose financial resources are used at the organizations’ inception. The companies exist because people invest their personal finances with profit in mind. As a result of this, management of corporations has a duty to earn profits in order to distribute it to the investors, called shareholders. The distribution is called dividends. It must be mentioned that this applies only to companies that pay dividends. For those that pay, the only way to accomplish these objectives is by careful application of funds in the course of business. Good application will yield the desired results, and financial returns will be made to the investors. However, if results are unfavorable, the investors will send a strong message to management, some of which include selling the company, selling their shares (cashing out), investigating the company, voting out the management and any other steps that appeal to the shareholders. According to Block and Hirt (2005), “if there is one talent that is essential to the financial manager, it is the ability to plan ahead and to make necessary adjustments before actual events occur” (p. 91). ‘Talent’ contextually means someone who has what it takes to perform tasks with excellence. In this case, it takes the knowledge of financial statements to perform the said tasks.

It behooves management, based on Block and Hirt’s (2005) revelation, to step up its level of awareness just for the purpose of satisfying the shareholders. That awareness can be achieved by way of strong grounding in the knowledge of finance and accounting principles. This will make for an understanding and easy interpreting of financial statements. Camilluca, Hymowitz, Karnitschnig and Carew (2008) studied General Electric’s bid to get rid of its appliances arm of business and commented, “shedding the appliances brand would be a symbolically significant move for the Fairfield, Conn., company” (p. 14). In the context of a corporation’s net income (which is the core of the intended overall research here), Camilluca et al. (2008) laments General Electric’s move because “GE entered the business in 1907 and boasts of milestones such as introducing the refrigerator, room air-conditioner and toaster oven” (p. 14). Incidentally, the economy is blamed by General Electric for such a decision as getting rid of its appliances arm of business.

For such a business that has existed for 101 years, it could have been said that bad economy was insufficient a reason to shut the doors. However, Camilluca et al. (2008) reveals that because the appliances brand gradually diminished to “a relatively small part of the company, a sale might not satisfy investors who are pressing Mr. Immelt to improve GE’s sluggish performance” (p. 15). The study shows that no corporation is exempt from the realities of harsh economy. It reports that the least that a corporation (and its managers) can do is watch the financial statements while they are still being prepared. In essence, the departmental contributions, the quality of managers, the level of employee awareness, and an ability to interpret the financial statements must be in place. Further than that, the use of the word ‘least’ shows that Camilluca et al. (2008) expect more from the fuctionaries.

In relation to the intended research, seeing that “GE reported an unexpected 5.9% drop in first-quarter net income and lowered its earnings forecast for the year, only weeks after issuing sunnier projections,” (according to Camilluca et al.), in all probability, the managers have adequate financial knowledge to keep the company for 101 years. They also have enough financial knowledge to understand that an unexpected 5.9% drop that lowers earnings only weeks after issuing very positive projections is portentous enough to warrant a ‘stop-loss’ action. In the words of Camilluca et al., “The move prompted the biggest one-day selloff in GE shares in more than 20 years” (p. 14). This scenario adequately illuminates the bright side of financial knowledge.

The main statements that show the overall health of the corporation are the balance sheet, statement of cash flows and income statement. Based on the above, department level managers must not only know about these documents, but also about the generally accepted accounting principles (GAAP) if they are to know when a unit should be expanded, contracted or shut down.

To buttress the argument regarding financial knowledge and its place within a corporation’s operations, Atkison (2008) took on the issue of supply chain, commenting, “It is important for supply chain executives to understand

supply chain finance, and how the financing can improve the velocity of the supply chain” (p. 7). The study rationalized the prior attention given to supply chain management, as well as the population of that field with individuals who possess management knowledge, experience and education, and are adjudged by human resource officers as appropriate for the job. However, the absence of finance discipline in the mix has continued to hurt supply chain, especially because the executives, as experienced as they might be, were found to be lacking in the area of finance. Therefore, their organizations suffered from the limitations placed on the bottom-line figures.

Addressing supply chain executives, Atkinson (2008) states, "They need to be aware of the impact that the introduction of financing at different stages of the supply chain can have on their operations" (p. 9). This appears to indicate that success in supply chain activities has to meet with financial knowledge at an intersection, and when that happens, there will be an increase in returns. If this interpretation is right, then, managers with financial knowledge will probably contribute positively to their organization's net income while managers with no financial knowledge will contribute not as much to their corporation's net income. This interpretation will be supported or debunked after the investigation activity.

Madura (2000) states, “degree of accounting exposure can be greatly affected by the accounting procedures it uses to translate when consolidating financial statement data” (p. 293), which means that talents must demonstrate knowledge of financial statements. They should be able to read, interpret and understand the contents thereof, and most especially be able to populate these three documents. Accounting and finance personnel are expectedly experts in the said area. Because department managers are not all from finance or accounting disciplines, this study would find out whether their non-accounting qualifications place them at a disadvantage, or whether they do not need to be exposed to finance or accounting in order to contribute effectively to the corporation's net income.

The mention of United States corporations also necessitates an acknowledgement of the concepts of centralization and decentralization in which some United States corporations run their organizations respectively from the home office in the United states or by empowering their departments, divisions or subsidiaries to exercise autonomies at various levels. The research conducted by Sorenson and Kyle (2008) looks at the situation that arises when a department faces the task of reporting its finances to the home office. The department in reference could be in difficulty explaining the conversion of currency between their location and the home office. If the manager of such a department, division or subsidiary falls within the category of the Americans that do not have financial knowledge, the corporation's net income will either be inaccurately reported or false altogether. It may not be an intentional falsification, but one that arises from lack of appropriate knowledge. However, based on either ignorance or unethical disposition of management, auditors, generally accepted accounting principles, and financial accounting standards board rules will catch up with such management. According to a categorical statement from the research,

Keeping accounting records in multiple currencies has made it more difficult to understand and interpret the financial statements. For example, an increase in property, plant and equipment (PP&E) may mean that the company invested in more PP&E or it may mean that the company has a foreign subsidiary whose functional currency strengthened against the reporting currency. (Sorenson and Kyle, 2008)

A subsidiary manager can only surmount the above difficulty if he or she possesses substantive knowledge of financial statements. Tayles, Pike and Sofian (2007) showed in their research findings that such knowledge should be based on an understanding of financial statements rather than ratios. In applying that research to Sorenson and Kyle's (2008), it must be confessed that when a manager has difficulty interpreting financial statements, a cheat-sheet of profitability ratios, liquidity ratios, leverage ratios and other necessary ratios can help the manager to report somewhat sensibly. However, when such a manager resides at the home office location and consequently not reporting financial results from an offshore location that has sovereignty (with its own national currency), the manager's dependence on ratios will give him or her out as hiding behind the mask of financial ignorance.

Sorenson and Kyle (2008) warned that a manager's difficulty in dealing with the relationship between home office currency and national currency of the off-shore division that he or she leads “may not seem like a significant issue, but goodwill arising from the acquisition of a foreign subsidiary may be a multibillion-dollar asset that will be translated at the end-of-period FX rate” (p. 11). If a corporation's net income is important to it, then the ability of its manager to preside effectively over financial reporting cannot be over-emphasized, be it in one or multiple currencies. Sorenson and Kyle's (2008) example with multibillion-dollar asset in a manager's division is enough for the manager to want to know enough for the purpose of carrying out his or her job. The emphasis of some corporations on intellectual capital refers subtly to the situation in Sorenson and Kyle's (2008) example.

## Examining Financial Statements

*Department Level Manager's Extent*

Following on the heels of Koenig (2004) and Moore (2002), Fogarty, Graham and Schubert (2007) bemoan situations in which employees lack the qualifications to fulfill their assigned functions (p. 64), as such situations constitute a set-back to the organization. Such employees may be skilled in their job functions. However, it has not been verified whether or not being skilled is enough tooling for the department manager to help the company increase its bottom-line figures. This is why an investigation is necessary to determine whether or not the manager needs knowledge of financial statements in addition. The extent of that knowledge is critical to the success of this investigation. A manager may produce positive results as his department's contribution to the corporation's overall net income. If such a manager has no formal education or experiential knowledge in financial statements, it will be unknown whether or not his or her departmental success could be greater if he or she had the knowledge of financial statements.

Roberts (2008) states that companies will soon have to respond "to regulatory pressure for forward-looking financial statements. The effect of this change will be felt not only in reporting but also in management practice, because it calls for an improvement in three areas: knowledge management, forecasting and optimization" (p. 8). This means that more work will go into the preparation and reporting of financial statements. He did not make this statement because he felt so. He saw a gaping hole in the systems adopted by corporations, and matched those against expectations of rules and regulations. His findings are that corporations can only live by the numbers that proceed forth from the financial statements. If Roberts (2008) condemns the low state of financial statements knowledge, and statistically identifies a need for improvement in knowledge management, with particular attention to forward-looking financial statements, then there must be a correlation between the knowledge of financial statements and a corporation's net income.

The study reports that the skills needed for an improvement in the identified three areas are lacking in most finance departments. The author consequently states, "firms will need to hire commercially astute specialists to make up the shortfall" (p. 12). However, based on the study also presented (in this overall research) that many Americans lack financial knowledge, hiring commercially astute specialists will probably be more difficult than training the already employed but less knowledgeable. According to Roberts (2008), "Progress can be accelerated by hiring consultants to coach internal high-flyers and provide reusable models and tools. Evidence from early adopters of these methods shows there are considerable profitability and growth benefits to be gained" (p. 19). If evidence already exists that an effort to improve management practice, forecasting and optimization produced results, then a targeted effort in the area of financial statements across the organizational spectrum is likely to produce high net income.

Using a United States corporation as an example, Roberts (2008) revealed that the head of human resources of a United States corporation reassigned a workforce planning manager as a full-time analyst in order to improve the way his team relates with numbers. According to the study, the newly reassigned manager only had minimal finance knowledge, but he was the only individual closest to numbers. His superior relied on the fact that the newly reassigned manager had 'inquisitiveness' as one of his strengths. Because of the ability to see a pattern or trend and become inquisitive, the head of human resources identifies him as someone who could be trained to bring the human resource department as close as possible to becoming an effective manipulator and user of financial information. According to Roberts (2008), the head of human resources does not expect his human resource personnel to become metrics expert, but to be curious and develop a culture of inquiry along financial lines. Going to such extents may produce the results intended by Roberts regarding hiring or training the high-flyers.

This is one of the reasons Fogarty et al.'s (2007) touch on auditor assessment of employees who lack qualifications in the area of financial statements addresses all managers irrespective of their educational or professional disciplines. Qualified Accounting and Finance managers may pass Fogarty's test, but if they are unable to contribute to the firm's net income, the auditor assessment of employees may classify them as lacking qualifications. This is because their ability to perform tasks for which they are employed would probably rank highest in the assessment. Auditors look at company-wide information. This means, therefore, that managers in departments other than finance or accounting must also know about the three main financial statements, or be desirous of going to such extents.

Furthermore, a manager's knowledge of what an auditor would be looking for will enable such a manager to keep records that truly reflect the financial health of his or her department, as the departmental figures feed company-wide numbers. This is especially true as Zikmund's (2008) research reveals that "an auditor must develop the requisite skills to detect fraud and obtain sufficient knowledge of the rules and regulations in order to better understand what is

required during an audit” (p. 8). For a manager, knowing what the auditor wants, based on Zikmund (2008), is half of the solution to any possible problems that may arise. The other half is keeping those records in ways that match the expectations of the auditor who is to come. The extent that the manager is willing to go reveals how much examining of financial statements he or she will do.

The research in reference reveals that the official statement on auditing standards, referred to as SAS 99, and titled Consideration of Fraud in a Financial Statement Audit, requires “an auditor to obtain ‘reasonable’ assurance that material fraud is not present” (p. 11) in the company’s records. If, therefore, a department manager’s numbers fed into the corporate books contained misinformation (whether intended or innocent), the statement on auditing standards (SAS99) will not dwell on the intentions or innocence. It will propel the auditor to into other appropriate rules that determine what happens to the corporation or to the manager. In a few words, Zikmund (2008) is teaching that the only way out of potential collisions is an intellectual capital concept that focuses on kitting management with the right knowledge for enabling the corporation to fulfill its main obligation – taking care of the well-being of the shareholders. The corporation cannot achieve that objective without having knowledgeable individuals in place.

### *Recognizing Financial Knowledge Need*

According to Gray (2007), “Just 31% of employers felt responsible for their employees’ level of personal finance knowledge. Many companies believed strongly that their staff would not expect them to play a role in this area” (p. 14). This means that those employees and managers within the organization need finance knowledge. This source acknowledges that both the corporation and the individual employee know about the existence of a knowledge gap. The company expects the employee to be finance savvy. The employee is more engrossed in working “the job,” making “the money” and living “the life.” Under these circumstances, the individuals do not have enough knowledge of their own finances.

Gray’s (2007) argument is that if the individual does not know enough of his or her own finance while working for the corporation, and is not curious enough to pursue such an understanding of it, then how much interest he or she will show in the corporation’s finances is left to guesswork. The research study shows that if an employee can explain his or her personal benefits and make portfolio choices, then that employee can understand the corporation’s finances and make informed decisions regarding the corporation’s portfolio in the areas of Financing and Investing, being two out of the three main activities of the organization. Incidentally, many managers make good decisions in the area of Operating. Gray’s (2007) research will be useful in getting managers to recognize the financial knowledge need and fulfilling the need.

One of the three financial statements that constitute the core of this overall research is the Cash Flow Statement. This particular statement shows three sections, Operating Activities, Financing Activities, and Investing Activities. Gray (2007) argues that the employee understands operating activities, being why he or she is employed. Those employed in the Finance and Investing areas of the company are expectedly knowledgeable in those areas. Gray’s (2007) research finds an unfortunate situation – that of an encompassing lack of understanding of personal finance. The study bemoans the dismal absence of individuals on whom the corporations could rely for the purpose of moving them forward when succession times come. In the light of all above, a corporation’s net income may be in jeopardy if such an organization has employees who fall within the category presented in Gray (2007).

In the light of the above scenario, an intensive review is necessary for the purpose of finding support for the possibility or otherwise of a corporation achieving high net income because its department level managers are knowledgeable in the area of finance.

Managerial responsibility in recognizing revenue is, therefore, impossible without the skill, knowledge or training in the appropriate accounting or finance topics. Fogarty, Graham and Schubert’s (2007) reference to auditors is frightening enough, referring to court action, and point in the direction of knowledge of financial statement as important to department managers. To buttress the point, Wells (2001) finds a bookkeeping employee, responsible for posting accounts receivable in a small business stealing some of the cash payments but nonetheless posts the transaction to the company’s accounts-receivable detail (p. 32), which draws attention to the effects of false debits, omitted credits and forced balances. If a department level manager with knowledge of financial statements routinely examines that bookkeeper’s journal entries, the disappearance of \$200,000 will not happen. This incident supports firm-wide review of financial statements by managers. Wells (2001) thus identifies and categorizes financial problems and risks in business systems into skimming, larceny and fraudulent disbursements (p. 33) and elaborately explains them. Financial problems thus identified support the recognition of a need for financial knowledge.

Skimming, larceny and fraudulent disbursements are among the prevalent slippages for which companies should develop or employ inspector type managers. Fraudulent disbursements, in particular, include increasing “soft”



expenses (for example, consulting or advertising), employee home address matches a vendor's address, vendor address is a post office box or mail drop, vendor name consists of initials or vague business purpose (employees often use their own initials when setting up dummy companies; for example, "JTW Enterprises"), and excessive voided, missing or destroyed checks (Wells, 2001).

Shaw (2007) states, "Managers feel managed by whatever lands in their in-boxes and they get trapped on a treadmill of PowerPoint presentations. But all that is set to change as the latest financial reporting rules make forward-looking statements mandatory" (p. 16). This highlights the same rules presented in Roberts (2008) and recognizes a need for financial knowledge. For these two researchers to harp on the imminent changes in financial reporting, a shift to rather targeted knowledge management or intellectual capital campaigns than general management development programs appears to exist. Shaw's (2007) thesis revolves around the finding that accounting practices are facing the need to change if organizations are to operate in line with rules set by the accounting standards board and any other relevant bodies. The study paid attention to knowledge management, econometric analysis, forecasting and optimization. These areas are essentially numerical.

Research study by Bovee, Kogan, Nelson, Srivastava and Vasarhelyi (2005) revealed that with the advent and pervasiveness of technology, especially with robust enterprise infrastructure, accounting software and applications markets have been gaining ground. Financial Reporting and Auditing Agent with Net Knowledge (FRAANK), an accounting package, is one of the results of that market growth. Its use simplifies process for management. However, knowledge of accounting principles and understanding of financial statements will enable a manager to comprehend the FRAANK process. Otherwise, a manager would be hiding his or her lack of knowledge behind the application. A manager in this situation is not required to be an auditor. Accounting software may be appropriate, but the manager's ignorance will be exposed if that manager relies wholly on the software instead of acquiring personal knowledge of calculations, determinant ratios, double entry and interpretation of numbers. Knowing ahead, therefore, what an auditor will look for when one comes enables the department level manager to carry out all the crosscheck that is necessary. In essence, the manager in this case will make the auditor's job easier than would a manager who lacks enough knowledge of the process to spot problems before they cause major disruption in operations. Financial knowledge need recognition will help an organization to nip this kind of reliance in the bud.

Highlighting the very dangerous potential outcome of systems failure, which can bring managers to their knees if they do not know basic finance and accounting principles, is therefore important. Bovee et al. (2005) explain, "Using FRAANK, companies can quickly compare themselves to competitors in their industry sector or market across a variety of standard financial ratios" (p. 38). Managers who lack knowledge of principles can rely on this package with bitter consequences. Reliance on accounting packages without an understanding of principles and an ability to manually work the problems can lead to colossal failure when systems fail. Obversely, knowledge of principles, backed up by technology, will create greater value because end-users are not blindly following keypunches. Supporting need recognition and the facilitation of relevant knowledge, Carnes and Glerlasinski (2001) reveal, "After years of foot dragging there is hope that change may be coming to academic accounting programs" (p. 381). This refers to a legislation requiring 150 semester hours of university study in order to sit for the CPA examination. Developments such as this prompt training departments of corporations to re-engineer expectations. The result is an increase in the level of finance-specific enlightenment of their departmental managers and ultimately an increase in net income. If a corporation does not recognize a need in this area, it may not act. Need recognition will be necessary for organizations that have a need. It must be stated, though, that need for financial knowledge cannot be assumed as a general rule.

### *Individual Breadth of Knowledge*

Management philosophy that borders on responsibility, touted over decades ago, includes a contribution by Perrow (1986) that manager qualities must change to match the increasing responsibility brought about by a changing marketplace (p. 59). Ordinarily, those qualities would have been simply associated with their job specializations or academic specialties. Incidentally, those qualities pertain to the job tasks and employer's needs. Those two items address organizational continuity as identified 13 years later by Cateora and Graham (1999). In the context of this investigation, the qualities that department level managers are expected to have in order to succeed in their respective organizations include an ability to read and understand, interpret and prepare financial statements. The contextual success pertained to the individual's ability to interpret, use and populate financial statements.

In a research study by Burgess (2007), a categorical statement stated, "Increasing pressure on profitability means it is essential to maintain tight controls, and hence there is an increasing role for managers in general to take responsibility for various financial aspects in their units or departments" (p. 117). This pressure often leads to

performance that is expectedly capable of producing high net income. Burgess found, in Scapens and Jayazeri (2003), the discussion of the constant evolution of management accounting, showing that line managers are now required to have greater financial knowledge and information, and be much more accountable for their actions. That corroboration probably responds to findings by Streeter (2007) and Mandell and Klein (2007), and relies on the fact that the pressure for profitability in Burgess (2007) will live up to the requirement to have greater financial knowledge. An individual's breadth of financial knowledge is apparently a major necessity in preparing for accountability on the job.

Burgess (2007) reports DeSouza and Awazu's (2004) findings that managers require accurate knowledge in order to constantly control the operations and they need to have better financial skills in order to effectively use this information. These findings are similar to those of Streeter (2007) and Mandell and Klein (2007). Under an atmosphere of financial knowledge and skills, individuals can accurately forecast and plan revenues and costs for themselves or their corporations. The generalizing of Burgess (2007) almost conceals the hospitality industry leaning of the research study. This shows that the needs are widely applicable to business, and that financial considerations probably underscore the success of every business. All these pointers appear to strengthen the need for determining where and to what extent financial knowledge contributed to net income.

Davidson (2006) states, "Clearly, we must improve the financial knowledge of individuals and governments, beginning with the financial education of young adults. This training should begin in our high schools and be emphasized in our colleges and universities" (p. 12). This means that the foundation for high quality department level managers must be laid at an early stage of their lives. The research studied a student investment program and found that it had real-world experience in the classroom for which Davidson (2006) interjects, "The Student Investment Program is a perfect example of hands-on, real-world experience in the classroom. However, it's just one component of financial literacy. And it's clear that Americans need this kind of financial knowledge" (p. 19). He explained that the young people in that classroom thereafter demonstrated increased curiosity, which had a potential to fuel their individual breadth of knowledge in that area.

Dennis (2006) reports on a midlevel management development program customized for Kaiser Permanente in which one of the directors participated. She explains, "The training covered five topics - strategy, communications, finance, knowledge management and change management" (p. 18). In order to highlight the substantive issue of knowledge (and in the finance area particularly), she reported the participating director as saying, "participating with other people from my company helped open my eyes to how the bigger decisions were being made" (Dennis, 2006). Because participants were drawn from the company's management team, and being health industry organization, finance was probably one of the last things they would expect. If an eight-week program for people in an industry that is far removed from finance would include finance and knowledge management, then managers in corporations should face the reality of learning that their organization's sheer existence depended on finance. This is because finance is the only instrument that a corporation can use to satisfy shareholders who hold the equity that is found on the bottom right of the balance sheet.

### Management's Knowledge Scenario

#### *Manager's Value-Added*

Gray's (2007) research results necessitated a look at Lusardi and Mitchell (2007), as they seem to be interested in similar situations. Lusardi and Mitchell (2007) investigated "the causes and consequences of financial illiteracy to better understand why retirement planning is lacking and why so many households arrive close to retirement with little or no wealth" (p. 8). The study is focused on the parallel view of the individuals from these households who are entrusted with leading departments and divisions of large organizations. It reveals that many families do not understand the basic economic concepts needed for personal wealth creation. If households have mostly such people as have been described, then department managers, coming from such households cannot camouflage their ineptitude and ignorance in suits, ties, briefcases and laptops.

The research finds that "Such financial illiteracy is widespread: the young and older people in the United States and other countries appear woefully under-informed about basic financial concepts, with serious implications for saving, retirement planning, mortgages, and other decisions" (p. 16). This means that majority of the people who are leading corporations or their departments are in danger of being overtaken by the tide of rough economic waters (Lusardi and Mitchell, 2007). For the purposes of validity, and in an effort to avoid bias, Lusardi and Mitchell (2007) stated, "Calvert, Campbell, and Sodini (2005) find that more financially sophisticated households are more likely to buy risky assets and invest more efficiently" (p. 9). This means that though within the populace, more individuals are

financially illiterate than knowledgeable, the few that are knowledgeable in the area of finance will reap whatever benefits exist for investors. They further revealed “Kimball and Shumway (2006) report a large positive correlation between financial sophistication and portfolio choice” (p. 13), buttressing the point that knowledge of financial statements is likely to equip a manager for the purpose of making portfolio choices for his or her corporation. Such an ability represents value-added for the corporation.

Financial statements are central to the overall research because they are the documents that contain financial numbers with which to work or calculate the corporation’s state of affairs at any given time. Lastly, Lusardi and Mitchell (2007) stated, “Hilgert, Hogarth, and Beverly (2003) also document a positive link between financial knowledge and financial behavior” (p. 10). This finding succinctly circumscribes the correlation that the overall research seeks. It is, therefore, expected that results from the impending survey should either prove these prior research findings right or reveal other phenomena, especially as Lusardi and Michell (2007) state that “Other authors have also confirmed the positive association between knowledge and financial behavior” (p. 14).

Revenues and their recording are crucial. In essence, revenues come in form of sales, and the financial statements display the applicable entries, and all these are facilitated by personnel, as underscored by Dennis’s (1999) revelations. If revenue is properly recognized, documentation will reflect such revenue properly also, and the company will consequently be positively disposed. However, if lack of knowledge or fraud causes slippage at this processing point, the display will be misleading until auditors find it. This means that recording is very important, and must be done in accordance with applicable rules set by the controlling bodies. According to Steinberg (1996), the relevant information can be displayed with a statement of changes in net position, containing such items as net costs, appropriations used, non-exchange revenues...net position—beginning of the period and net position—end of the period (p. 7). Making accurate entries is the responsibility of all concerned employees. However, it is more applicable to those who add value to themselves and consequently to the company.

#### *Effect on Net Income*

A manager can add value to the company if he or she understands the inputs of financial statements. This knowledge enables such a manager to manage the firm (or department) better. Therefore, a department level manager’s knowledge or lack thereof of financial statement expertise has a bearing on firm-wide net income. This can be noticed in that manager’s interpretation and application of documents such as Cash Flow Statement, Balance Sheet and Income Statement. The bearing will be positive or negative, and has a capacity to affect net income accordingly. Albrecht, J. Stice, E. Stice and Swain (2005) warn, “unless someone is watching closely, the theft may go undetected” (p. 258). A manager who is knowledgeable in financial statements can interpret entries and save the organization from pen robbery, which will in turn translate to an increase in the bottom-line figures. Demonstrating expertise allows a manager to carve a niche within and outside the organization, as that knowledge will be resounding even among competition because the final accounts, when published, will indicate that some expertise may have been demonstrated.

Dolvin and Templeton (2006) viewed Crenshaw’s (2005) research survey conducted by Hewitt Associates LLC, regarding employees’ abilities to make financial and investment decisions, and agreed that the workers so surveyed lacked financial knowledge. The survey also indicated that as a result, employers are increasingly offering education opportunities. Unfortunately, many employers still doubt the overall effectiveness of these programs particularly considering that many workers choose not to take advantage of this financial education. This means that solution to lack of financial knowledge is either not being found or is very slow. Net income is affected positively or adversely as a result.

According to Dolvin and Templeton (2006), “The results of this study suggest that financial education aids employees in choosing more appropriate asset allocation percentages, as well as more efficient portfolios” (p. 118). They believe that the improvements witnessed may have resulted from a deeper understanding of the intricacies of financial management, and from a reduction in the psychological biases typically exhibited by unsophisticated investors (Dolvin and Templeton, 2006).

Eilifsen and Messier (2000) review misstatement, which is a major problem in financial statements. Misstatements are cost factors. They can only increase net cost. One of the purposes of management is to identify the force behind such misstatements, especially as most are believed to be errors of omission. However, due to widespread fraud in organizational accounting, a need to study that phenomenon with a view to arriving at a scientific conclusion seems to exist. Incidentally, archival evidence reveals, “smaller companies are likely to have a higher incidence of misstatement than larger companies because of weaker internal controls” (p. 34). This means that organizational size has a role to play. The problem lies in personnel. High level of commitment to organizational efficiency and knowledge are likely to help lessen the incidence of misstatement and other ills that adversely affect an organization’s

net income.

Misstatements could also be errors. One occurrence may not raise a flag. However, two or more restatements of errors may occur and raise questions about ethics. Zhang and Pany (2008), in dealing with ethical issues within a corporation, state, "Restatements for accounting errors occur when material errors existing in financial statements are not detected by either internal controls or external auditors prior to the issuance of the financial statements" (p. 44). The authors chose to use an extreme case to highlight a colossal situation that can engulf a corporation. These authors are exhibiting their awareness of the power of controls (internal and external). These controls can only be exercised through a thorough application of the rules of double entry, due consideration of generally accepted accounting principles and rapt attention to financial accounting standards (rules). Based on Zhang and Pany (2008), these considerations are only possible if the manager and his or her team have enough knowledge to do those things that are necessary, particularly for the purpose of protecting company net income.

Zikmund's (2008) earlier reference to restatement of accounting errors draws immediate attention to SAS99 (statement on auditing standards), and relates to the situation presented by Zhang and Pany (2008), to wit, there should be no material fraud in the entire process. If Zikmund (2008) and Zhang and Pany (2008) though not related in any way, are pointing out the same problem that can only be solved through knowledge of financial statements, then all officials that are connected with the process of entry, recording, reporting and presenting any or all aspects of a corporation's accounts are likely to need a high level of awareness. This level of awareness is probably only available through concerted efforts. Those efforts are also probably visible only in training programs, intellectual capital concepts, targeted seminars and streamlined finance and accounting training for all managers and their personnel regardless of their disciplines. From the point of view of Zikmund (2008), any appearance of repeated accounting errors means fraud (to auditors), and triggers an application of the rules set by accounting standards board. This implies that all well-meaning functionaries desire to shield the net income from erosions caused by either lack of knowledge or fraud.

### *Responsibility and Accountability*

Hemraj's (2002) research study is easily a safeguard for department level managers who reveal what auditors want, defining and clarifying the need for audit. Other important knowledge nuggets are included so that department level managers may stay ahead of the game. As earlier ascertained, not having a finance or public accounting training cannot absolve a department level manager when dangerous slippages manifest in organizational sub-domains manned by them. Furthermore, since auditors and courts of law are usually mentioned regarding recognizing revenue and recording journal activities, knowledge of financial statements appears not to be negotiable. This is also very crucial because of the need for companies to provide summary statements of their internal financial plan and projections of the statement of assets, liabilities and income (Hemraj, 2002, p. 58). This accountability and responsibility function appears to be related to the public display of final accounts. This is probably in line with the publishing of final accounts by public corporations in all conceivable media including the Internet.

Knowing these forms and versions of financial statements converts a departmental manager from just a paid worker to a knowledgeable social capital that may consequently become indispensable. Keeping the net income in focus enables the departmental manager to support the Chief Finance Officer (CFO), and successfully deliver it to the shareholders. A conscious sequence, according to Hemraj (2002), must be instituted with an ultimate goal of rewarding shareholders. This also means that when a CFO places the demand on department level managers to know financial statements very well, regardless of their departments, the organization will presumably be fulfilling its reason for existence. This presumption can only be confirmed through a scientific process.

Evidences show that domestic and international organizations rely on the same principles and pursue the same goals (net income) to fulfill their reasons for existence. Cateora and Graham (1999) highlight a good parallel with happenings in domestic and international business arena, drawing attention to organizational needs, situations and goals, stating that these goals can only be achieved by building on relevant knowledge (p. 436). Making that presentation from the point of view of international marketing shows that department level managers in departments other than finance and accounting are not excluded from pursuing organizational continuity (a shareholder dream), character (every investor's demand), coverage (every company's plan), control (every top management's nightmare), capital (every CFO's battleground), and cost (every department's ghost).

Further lessons from Cateora and Graham (1999) include that if the international marketer needs a clear understanding of market characteristics, having established operating policies before beginning the selection of channel middlemen, then department level managers must understand the characteristics of their departments' vis-à-vis corporate goals. Among other pre-selection considerations are the specification of financial and personnel

commitments to the development of international distribution (Cateora and Graham, 1999). This situation applies to all organizations, and must be viewed from the angle of economic and social responsibility, which is not separated from accountability.

### Conclusion

From the foregoing, there appears to be a high demand for finance and accounting education for all cadres of management. Public corporations' final accounts are published even on the Internet. A search through those documents does not reveal the percentage contributions of their respective department managers towards the net income. It is not known whether top executives of those companies are unwilling to volunteer data on their managers' departmental contribution as a percentage of the company's bottom-line figures. Therefore, generic data that tie managers' needs for an accounting background to the bottom-line figures are hereinafter appended as tables. Though they provide a bird's eye view of the pertinent data, they can be better understood through a formal study.

A formal approach through the Delphi Method would use the consensus-building component of that design to elicit authoritative data that will be transferable, credible, dependable, and confirmable. These factors of trustworthiness would backup the data mined through the Delphi technique to support or defuse the apparent need or high demand for finance and accounting education for all cadres of management. Albrecht et al. (2005) confirm, "all businesses, large or small, periodically issue their financial statements so that users can make sound economic decisions" (p. 94). Management relies on those statements and is usually pleased when the books record high net income. However, more knowledgeable managers are needed, based on the foregoing. Unfortunately, incidents such as ignorant slippages and creative robbery with the pen occur due to the absence of such knowledge and eagle eye within the rank and file of departmental managers, as also pointed out in some researches reported above.

The absence of finance-specific knowledgeable managers prompts Wallace (1997) to ask, "Where are the debits and credits?" (p. 229). The anomaly identified by her showed that individuals paid more attention to FASB's rules regarding reporting instead of looking to journal entries. This is because they want to only satisfy Financial Accounting Standards Board (FASB), an organization in the United States that is in a position of authority to set standards guiding the reporting of financial and accounting records within the country. Wallace's reference to it shows that she insists that what the readers see is what they get. This means that presenting something that makes sense is better than creating a document that mechanically satisfies rules of the accounting standards board, and thereby faking a good report. She wants every department level manager to know where the debits and credits are. Otherwise, cataclysmic outcome will become the order of the day. Managers must be made to look into accounting journals and answer Wallace's (1997) question, "Where are the debits and credits?" (p. 229), which, in addition to her comment and the charge she placed on the department level manager, point to the need for managers to display high ethical level at work.

In summary, scholars have put out results of their findings in multiple directions that relate to the subject of these reviews. Some of the assertions and direct reports from the reviewed scholars may create a temptation to draw conclusions, but because they did not deal with the niche carved by the intended investigation, they will only be used as stepping-stones to guide the pinpoint investigation. It is clear, though, that knowledge is generally important. Based on the reviewed scholars, it makes perfect sense to employ and retain managers who possess pertinent knowledge of finance, whether they are finance specialists or generalists in management, arts or the sciences. The manager's understanding of financial and accounting rules and regulations has been suggested. His or her ability to conscientiously examine financial statements has been recommended. Careful appreciation of his or her level of understanding has also been supported by scholarly literature. It becomes the responsibility of the intended investigation, therefore, to find out whether or not, and to what extent, a manager who possesses and applies the knowledge of financial statements contributes to his or her corporation's net income.

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