

Chapter 1

AN INTRODUCTION TO MANAGEMENT ACCOUNTING

Key Learning Objectives

By the time you have finished studying this chapter, you should be able to:

- explain the meaning and nature of management accounting;
- describe the scope and content of management accounting;
- discuss the past and current issues affecting the evolution of management accounting;
- list key factors that need to be considered when designing management accounting systems.

The Nature and Role of Management Accounting

This chapter will introduce you to the world of management accounting by presenting an overview of the areas of work in which management accountants operate. It will commence by explaining the nature and scope of management accounting. You will see that management accounting is an evolving subject and that its nature and scope have changed and expanded over time, and will continue to do so. As the world of accounting has expanded, so specialities have developed, and we shall see that management accounting is one such speciality, having its own distinctive features and accepted areas of operation. You will see that, in a number of ways, management accounting is quite different from other forms of accounting.

The chapter will examine the historical beginnings and contexts of management accounting, and will consider the nature of the forces and circumstances that have shaped its development. Consideration will be given to the influences that continue to shape management accounting's current development and the likely future influences to which management accounting must respond in order to retain its relevance and effectiveness. In particular, we will consider some of the 'softer' factors that affect any area of

management science, including that of management accounting, and will examine the conditions and system requirements necessary for the successful implementation and maintenance of management accounting systems. We will see that, like many areas of accounting in the current organisational environment, management accounting is not necessarily an exact, entirely reliable, science. Some of these issues will be introduced within this chapter and then developed in later chapters.

What is Management Accounting?

What is management accounting? One might think that a book devoted to management accounting would have little difficulty in answering this question. Not necessarily! A logical start is to examine the words ‘management’ and ‘accounting’ individually. Unfortunately, neither of these words has a single, universally agreed meaning. *Management* might be seen to encompass the entire range of activities involved in running an organisation, not forgetting that organisations take many forms, including businesses of many types and not-for-profit organisations, within the private or public sectors. *Accounting* may be seen to encompass any of the activities that attempt to gauge the performance of an organisation, or to plan for an organisation’s future performance. Additionally it may be seen to include the traditional ‘accounting’ roles of stewardship, control and audit. The layman might think of accounting as being concerned only with those *financial* measurements undertaken by those with the title ‘accountant’ and of management as being concerned only with those activities undertaken by those with the title ‘manager’. Neither is the case in real life.

In competitive business environments, and within a public sector that is increasingly focused upon effectiveness, value for money and ‘best practice’, all organisational participants take on a responsibility for both management and accounting. The actions of each individual within an organisation have, after all, ‘trickle-down’ effects on other parts of the organisation and an ‘upward’ effect on the eventual results of the organisation as a whole.

So, then, what is management accounting? Well, in a nutshell, management accounting is accounting (i.e. producing useful information) for management (whoever those managers happen to be and whatever their job titles). In this sense, ‘accounting’ includes the production of all information useful in running the organisation. Hence, such information may be:

- financial or non-financial;
- accurate, or broadly correct;
- actual (certain) or estimated (uncertain);
- based in the past or the future;
- detailed, or in a highly aggregated form;
- presented in any of a variety of spoken or written forms, such as numbers, tables, and graphs;
- related to profits/losses, costs/incomes, volumes, quality indicators, trends, etc.

Similarly, ‘management’ may include the activities of individuals in a number of positions, for example:

- senior managers;
- mid-level managers;
- lower-level managers;
- executive directors with management responsibilities;
- employees not usually considered to be ‘managers’, such as production line workers, call-centre operatives, and salespeople.

Thus, in many senses, an average person might not consider many of the areas of activity of management accounting to be accounting at all! Indeed, some writers have suggested that the term ‘management accountant’ should be replaced with a term such as ‘information manager’ in order to signify the wide scope of management accounting. Drucker (1994) has, for instance, suggested that the term ‘manufacturing economics’ might be a better contemporary term than management accounting, within the manufacturing environment. Obviously, a different term would be required for the public sector aspects of management accounting. Interestingly, in recent years, management accounting organisations such as the UK’s Chartered Institute of Management Accounting (CIMA) have taken a more wide-ranging view of the scope of management accounting and have tended to take a more broad ‘management consultancy’ view of the work of their members. Perusal of a recent issue of CIMA’s monthly journal *Financial Management* will confirm this trend. It is interesting, too, to note the recent change of name of this journal from the former *Management Accounting*. This name change and the changing emphasis of CIMA have not, however, met with the universal approval of its members, some of whom take a narrower view of what management accounting should encompass.

A selection of definitions of management accounting, from a range of books on the subject, illustrates the variety of definitions possible. Garrison and Noreen (2000: 4) state that *managerial* accounting (essentially a US term for management accounting – but see Proctor’s views below) is ‘concerned with providing information to managers – that is, people *inside* an organisation who direct and control its operations’. They continue that it ‘provides the essential data with which organizations are actually run’ and (2000: 34) that it is ‘concerned with providing information to managers for use in planning and controlling operations and in decision making’. Note, here, the distinction made by Garrison and Noreen between planning, control and decision making. It is our view that planning, control and decision-making activities are inextricably interlinked. Planning, for example, can be seen as decision making for the future, and control can be seen to be ensuring that the decisions of the past are carried out (as well as ensuring that such decisions are still appropriate).

Proctor (2002: xvii) offers the following explanations of management and managerial accounting, making a distinction between the two terms:

Management accounting is orientated towards the future. It is primarily concerned with the provision of information to managers to help them plan, evaluate and control activities. It is

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essentially a service function; a means to an end rather than an end in itself. Managerial accounting also fits this description but the use of the word ‘managerial’ emphasises the service role. This may seem obvious but, for much of the twentieth century, management accounting was used mainly to serve the needs of financial accounting, rather than to assist managers in their tasks. ... Managerial accounting is about improving the future performance of organisations.

Proctor emphasises that management accounting is not an end in itself. In essence, the slogan ‘If it’s not useful, it’s not information’ applies.

Wilson and Wai (1993: 15), writing about *managerial* accounting, offer the following observations:

Managerial accounting encompasses techniques and processes that are intended to provide financial and non-financial information to people within an organization to make better decisions and thereby achieve organizational control and enhance organizational effectiveness.

It is this last definition that we consider to be the most representative. Note that Wilson and Wai’s definition is broad in scope, reflecting management (managerial) accounting’s broad base, and that the definition incorporates aspects of many areas of study, all inter-related with management accounting:

- both *financial* and *non-financial information* – requiring management accountants to be more than just characterless ‘bean-counters’. Additionally, management accountants deal in *information*, not just data, and thus must have the requisite skills to produce useful, meaningful, relevant information. Management accountants must ‘add value’ to *data*, processing it into useful *information*.
- the provision of information to *people* – requiring management accountants to have ‘*people skills*’ and be able to *communicate* effectively.
- *organisational control* and *effectiveness* – requiring management accountants to have the ability to see the implications of their advice for the whole organisation and to understand how the various parts of the organisation are interrelated (i.e. the ‘soft’ (people) parts as well as the ‘hard’ parts).

Management Accounting and Financial Accounting

As seen above, management accounting has a rather broad potential coverage as compared with *financial accounting*, the latter possibly being a more generally understood term. *Financial* accounting is defined by the *Oxford Dictionary of Accounting* (Hussey, 1999) as:

The branch of accounting concerned with classifying, measuring, and recording the transactions of a business. [It is] primarily concerned with providing a true and fair view of the activities of a business to parties external to it. ... Financial accounting can be separated into a number of specific activities, such as conducting audits, taxation, book-keeping and insolvency ...

Thus, financial accounting can be considered to have a more narrow and specific/precise coverage than management accounting. However, the following points are worth noting:

- Although financial accounting is often considered to be a more ‘exact science’ than management accounting, this may not be the case, as can be seen from the recent spate of reported accounting scandals around the world. Both forms of accounting make extensive use of estimation and both may be subject to the application of ‘creative accounting’. Consider, for instance, the current debate on the valuation and disclosure of organisations’ pensions liabilities. The actuarial evaluations of such liabilities may justifiably take many approaches and may arrive at vastly different values for the same organisation.
- Financial accounting is no longer the relatively straightforward affair that it once was. The increasing complexity and sheer volume of financial accounting standards, designed to cope with the increasing complexity of the business world and, for instance, the explosion in financial instruments, have helped to expand the world of financial accounting. Additionally, attempts to harmonise the various systems of accounting standards across the world (e.g. the implementation of International Financial Reporting Standards by all EU listed companies’ group accounts by 2005), increasing public interest in corporate governance and the increasing focus on making the public sector more accountable have all contributed to the accountant’s workload. This ensures that financial accounting is a ‘cutting edge’ subject that can be fascinating (well, to some people, at least!). The international standard dealing with financial instruments, IAS39, is an excellent indicator of the complexity that may be inherent in a single accounting issue, and the arguments it has caused show that there is rarely a universal acceptance of any single accounting approach.
- Both management accounting and financial accounting can maintain their currency only by evolving to keep pace with changes in the organisational environment. Both types of accounting, therefore, are very much ‘living’ subjects.
- The boundaries of financial accounting have become more blurred as financial accountants have increasingly moved into the (more lucrative) areas of taxation advice, financial consultancy etc., raising public concerns, in recent years, about accountants’ conflicts of interest.
- Both management accounting and financial accounting can only be truly useful by presenting information to the right people at the right time and in ways that are meaningful, transparent and cost-effective. There can therefore be no room in the modern organisation for information and for information-gathering methodologies that have outlived their purpose.

The History and Context of Management Accounting

So, where did management accounting come from? Who invented it? Why was it developed, and by what types of person? As with most forms of historical study, a number of

partly conflicting ‘stories’ or paradigms exist, each claiming to give authoritative responses to such questions. Such ‘stories’ may concentrate, according to the slant adopted by their authors, on the commercial, organisational, cultural, sociological, political or ideological aspects of management accounting’s history. The past few decades have seen an explosion in the amount and variety of research undertaken into management accounting’s history, practices and trends. While some of this research might be criticised for being repetitive, unnecessary, too specialised and/or impractical, this research base at least provides a wealth of ideas to increase our understanding of the possible forces that shape management accounting. An understanding of these forces is useful in considering individual scenarios within which management accounting is applied and in analysing the likely or observed outcomes of such applications. In this book we will provide information to encourage further background reading, along with summaries of some influential and ground-breaking papers. Obviously, there is a limited amount of time available to you for such background reading, but it is often only by going back to the original papers that you can fully appreciate the worth of such contributions to the literature. Some of these papers can be surprisingly readable; others may be less so! A number of specialised texts on such papers, covering a wide variety of management accounting related subjects, have been produced in recent years, two examples being Ashton *et al.* (1995) and Emmanuel *et al.* (1995).

Excellent analyses of the history and context of management accounting, taking a variety of perspectives, have been provided by writers such as Loft (1995), Roslender (1995) and Johnson and Kaplan (1987). Some aspects of these and similar papers will be expanded upon in later chapters, although summaries of some issues are provided in the sections below.

Within such papers you will see that management accounting’s past, present and future development as a profession may be dependent upon a wide range of factors. Writers of such papers may focus upon such questions as the following:

- In what ways was management accounting created and developed as a response to changes in the industrial/business/organisational environments?
- Does management accounting merely follow and react to changes in business (and other) environments, or does it take a more active role in shaping changes in those environments? To put it another way, is management accounting *passive* (reactive) or *active* (proactive)?
- To what extent do the observed changes in management accounting practice and research fit in with other schools of thought in areas such as sociology and philosophy?
- What is the significance for management accounting of areas of study such as ethics and power relationships?
- To what extent are changes in management accounting shaped by political and ideological processes?

Such questions are addressed by different writers in a variety of ways. Loft gives an overview of a number of different ‘schools of thought’ on management accounting’s history. Roslender looks at the context of management accounting within a framework of critical theory, relating it to a number of recognised social models. Johnson and Kaplan

give their own analysis of management accounting's history and apply this to their theory of why management accounting lost some of its relevance during the later years of the twentieth century. Merchant (1998) and Robson and Cooper (1989) respectively give their observations on the relationships between management accounting and theories/models of ethics and power/control.

The Scope of Management Accounting

As explained earlier, there is no single definition of what management accounting is, or of the areas of work that it includes. Additionally, as management accounting continues to evolve, some areas of its coverage may become obsolete and be discarded, and some new and initially unfamiliar areas may gradually become accepted as mainstream management accounting activities. Table 1.1 summarises some of the areas considered to be part of 'management accounting', based upon a study of contemporary management accounting textbooks. One word of warning: just because a topic is contained within a textbook, it is not necessarily part of current management accounting practice. Reasons for such a mismatch include the fact that textbooks may not be able to keep pace with changes in practice (this is not just a management accounting problem) and that textbooks may contain some 'ideal approaches' which have not yet been put into practice, or which are unlikely to ever be actioned. Some of the terms within Table 1.1 may be unfamiliar to you. Don't worry: these will be explained in later chapters. Table 1.1 concentrates on relatively 'high level' activities. Bear in mind that 'calculating the profitability of products, services and operations', for example, will involve a range of 'lower level' activities including allocating costs to products, setting inter-divisional transfer prices, and so on.

Table 1.1 Some areas of activity considered to be part of 'management accounting'

Budgeting, planning and forecasting
Calculating the profitability of products, services and operations
Measuring organisational, divisional and departmental performance
Comparing results and performance within and between organisations
Assisting in the process of increasing effectiveness and efficiency
Assessing the performance of past and future capital investments
Advising on decisions about product mix, markets to be served and selling prices
Advising on decisions on whether to outsource products, components, activities and services
Advising on decisions involving the investment of scarce funds between a range of possible alternatives
Assisting in the making of a wide range of strategic decisions

Similarly, ‘assisting in the process of increasing effectiveness and efficiency’ may include a range of specialised techniques such as activity-based cost management and theory of constraints.

If you browse through other texts on management accounting you will find that the authors have different ideas about what should be included within ‘management accounting’. One specific area for which differences of opinion are found is that of financial management or managerial finance. Traditionally, within the syllabuses of professional accountancy examinations, and also within universities’ accounting syllabuses, boundaries have been drawn between ‘management accounting’ and ‘financial management’. This is often done as a pragmatic solution to the problems of achieving manageably-sized syllabuses for use within modularised courses. Like the boundary between financial accounting and management accounting, the boundary between management accounting and financial management is also rather blurred. Similarly, the scope or coverage of ‘financial management’ is not always well defined. Texts on financial management tend to have certain areas of coverage in common, such as financial theories concerning the pricing of financial instruments, the calculation of the cost of capital and the implications of gearing, dividends, the effects of risk, treasury management, and so on. The area of capital investment appraisal, that is, the appraisal of the implications of proposed investments for the value of the organisation (via the application of discounted cash-flow techniques), is usually covered by financial management texts but is also covered by many texts on management accounting. One possible reason for this dual coverage is that capital investment appraisal deals with investment decisions that have a strategically important effect upon the organisation. Thus, when the strategic aspects of management accounting are considered, such investment decisions are part of the work of management accountants. Similarly, when the strategic financing decisions related to such investments are made, these decisions form part of financial management. What is obvious, then, is that such strategic decisions cannot be made in a one-dimensional way. Their impact is such that all aspects must be considered and all interested parties (financial managers, management accountants, financial accountants, etc.) have a part to play.

For completeness, capital investment appraisal techniques will be incorporated within this text, as an understanding of these techniques and the ability to apply them competently is essential to management accountants, as is the ability to work and communicate effectively with financial managers, financial accountants and other managers. The importance of the various professional disciplines working together in order to reach decisions that have considered a broad range of issues (i.e. a *holistic* approach) is a theme that continues throughout this text.

Users of Management Accounting Information

Who uses management accounting information? As explained above, anyone who needs information to manage the organisation. Think about the people involved in managing the activities of a typical company. The following are some examples:

- A *sales manager* would require information about sales trends, profitability, stock levels, stock turnover rates, salespeople's performance (measured in a variety of ways), customer 'hit rates', sales volumes and values by customer, area, sector, product line, etc.
- A *production manager* would require information about production rates, production efficiencies, machine capacity usage, productive employee performance, quality measures and trends, stock levels, throughput rates, wastage rates, etc.
- A *human resources manager* would require information about absenteeism rates, lateness, sickness levels and trends, staff turnover rates, recruitment costs and the effectiveness of the recruitment process, training rates and success rates, comparative salary and wage levels etc.
- An *office manager*, in addition to the types of information relevant to the human resources manager, would require information about matters such as the performance of the particular office, however measured, the extent to which service level agreements with other offices had been met, the overall effectiveness of the processes carried out by the office, budgets for the office and the extent to which these are being met, the cost implications of future services to be provided by the office, comparisons between the costs of services provided by the office and those of potential external providers, etc.
- A *procurement manager* would require information about stock and procurement order levels, the effectiveness and costs of procurement processes, the cost implications of alternative procurement approaches, the comparative costs of alternative suppliers, procurement channels etc.
- A *director* or other high-level manager would require information on all of the above matters but, of course, at a more aggregated, summarised level. The high-level manager needs to be able to 'see the wood for the trees' and hence her/his information requirements will have a more strategic bias. Additionally, this type of manager would be more interested in the wider, longer-term and political aspects of the organisation's business and thus the appropriate information requirements may be broader in scope, less accurate, and more frequently exhibit a non-financial bias.

Of course, information along the same general lines will also be required by managers within a public sector organisation, or a not-for-profit organisation. The following are examples, within public sector organisations:

- A *housing department manager* will require information about occupation rates, tenant turnover rates, the capital costs of housing programmes, the comparative cost implications of different approaches to the provision of social housing, etc., as well as the types of information identified earlier relating to staff performance, budget performance, and service level agreements.
- A *hospital manager* will require information (depending upon her/his specific role) about such matters as bed occupation, waiting list trends, surgical success rates, cost effectiveness of surgical procedures, comparative costs of alternative suppliers, budgetary matters, etc.

Additionally, information of many types will be required, or at least be of interest, to employees of the organisation, whether or not they are considered to be ‘managers’ in the formal sense. The following are examples of such uses of management information by employees:

- Efficiency of the employee’s department, production line, division, etc., as compared to that of others – particularly if the employee’s monetary or other rewards are dependent upon performance.
- Comparative wage levels – particularly if wage negotiations are impending.
- The profitability and general performance of the organisation, as compared with that of competitors – particularly when job security is being considered.
- The employee’s own performance, however measured, as compared with that of other employees – particularly when the employee is considering applying for promotion.

One further issue to note is that what constitutes ‘management accounting information’ will depend upon the uses to which such information is being put and upon the ‘level’ being considered. Within the public sector, for example, information that a lower-level clerical officer may consider to be ‘management accounting information’ may be considered by a high-level manager to be excessively detailed data. Similarly, the data that the high-level departmental manager thinks of as management accounting information would not be considered as such by a national or supranational organisation working at a sectoral, country or economic zone level. For organisations such as the International Monetary Fund, the Organisation for Economic Co-operation and Development (OECD) and the European Union, the ‘detail’ may consist of the total results for entire countries or states.

Issues Affecting the Evolution and Design of Management Accounting Systems

There are many versions of the ‘truth’ about the roots and evolution of management accounting. Some authors describe the evolution of management accounting in terms of the ways in which it can be seen to have followed, or in some cases acted as a catalyst for, changes in the ways in which organisations operate. Others describe changes in management accounting as functions of societal and other factors that have simultaneously caused changes in organisational behaviour. Some (a minority of) authors see management accounting as a symptom of perceived ills in society – as a tool of the operation of subversive forces.

An excellent account of the history of management accounting is given by Loft (1995). Loft describes a number of ‘schools of thought’ on the history of management accounting:

- the *traditional*, or *neo-classical revision* school;
- the *relevance lost* school;

- the *labour process* school;
- the *radical* school

A summary of Loft's account is given in the recommended further reading section at the end of this chapter. In basic terms, Loft's 'schools' have the following features:

- The 'traditional' school sees management accounting's roots in the late nineteenth century, whereby systematic costing methods evolved as a response to the problems caused by the Great Depression (1873–96). Many of the 'best methods' of management accounting are considered to have been developed during the early twentieth century as 'tools' of the manufacturer. The 'neo-classical revision' school argues that the birth of management accounting, as a way of profit maximisation and competitive defence, was as early as the late 1700s.
- The 'relevance lost' school (so called after Johnson and Kaplan's text) sees management accounting as having been a key factor in co-ordinating firms' activities over large geographical areas. Here, management accounting is seen as a necessary device that enabled the capitalism of the late nineteenth century and the rapid expansion and globalisation of companies during the twentieth century. Management accounting is seen having been a useful ally to scientific management approaches. However, the 'relevance lost' school argues that most of management accounting's main advances had been made by the early twentieth century and that it has failed since to respond to or anticipate changes in business/organisational environments, thereby losing much of its relevance during the later twentieth century.
- The 'labour process' school sees management accounting as one significant aspect of changes in the ways in which labour and processes of managing labour have been controlled, leading to a progressive alienation of the workforce. Significantly, this school sees management accounting and accountants as instruments applied by exploiters of labour – as means of reducing the power of the labour force – thereby allowing domination and 'empire-building' by the owners of capital.
- The 'radical' school has similarities with the views of the 'labour process' school and further sees the use of management accounting by organisations as part of the process of creating the 'governable person'. Here, management accounting, with its traditional focus on financial measurements and systematic surveillance of the workforce (with associated rewards and penalties), is likened to the systems of discipline and surveillance used in other institutions.

You may consider some of these views to be a little 'over the top'. Some of them may seem to have the essence of 'conspiracy theories' about them – only time will tell whether these or new alternative 'stories' are most accurate. Some things are clear from the above views. Management accounting either acts passively or as an active force for change. Where management accounting is an active force for change, this force may have been applied consciously or accidentally. There are, therefore, a number of implications for management accounting as a profession:

- If management accounting has acted predominantly in a passive way, there may be potential for management accountants to take more responsibility for creating beneficial change, rather than ‘parasitically’ responding to the efforts of others.
- If management accounting has acted predominantly in an active but accidental (unconscious) way, then it may have been causing unnoticed but adverse consequences for society. Maybe management accounting should face up to its responsibility to identify and consider the consequences of its actions.
- If management accounting has acted in a consciously active way and has been the cause of the adverse effects identified by, for example, the ‘labour process’ school, then maybe management accounting should act in a more responsible fashion and consider its ethics.

Whichever way we look at it, management accounting seems to have an important role to play within organisations and, as a profession, it should not operate in a vacuum, oblivious to the many potential offshoot effects it may cause. Among the many possible dimensions with which management accounting may interact are the dimensions of ethical behaviour, corporate governance, empowerment, agency theory, contingency theory, and so on. Additionally, the management accounting press has seen the appearance and disappearance of many ‘new ideas’ and ‘cunning plans’ over the years. Many of these ideas have turned out to be either impractical, lacking in substance or simply carefully repackaged old ideas. We will revisit some of these matters in later chapters.

The Time Dimension of Management Accounting

The *Time Focus* of Management Accounting

As you may already realise, the focus of *financial* accounting is the past. Conversely, management accounting’s focus is in the *future*. Practically all of the areas of activity considered to be part of ‘management accounting’, as identified above, are focused upon the future. Budgeting, planning and forecasting, calculating the profitability of products, advising on short-term decisions and on longer-term major investment decisions all involve looking ahead in time. Admittedly, measuring performance and calculating product costs for previous periods involve looking backward in time, but such activities are carried out for one purpose only: to improve performance in future periods. The advice provided by management accountants can have value only if it is focused upon the future. Who would, for instance, employ a management consultant merely to pick holes in past performance? The whole point is to ‘add value’ by avoiding similar mistakes in the future, to learn from past experiences and to benefit from the insight of those who have ‘been there before’.

The *Time Periods* (periodicity) of Management Accounting Information

Financial accounting has, as we have seen, a retrospective focus. Additionally, because of its nature and the demands placed upon it, it tends to be reported upon at regular intervals. For the purposes of publicly available financial reports, financial accounting information is produced at least annually or, in the case of listed public companies, on a biannual or quarterly basis.

Management accounting information may be produced regularly, for instance on a monthly or weekly basis, or on a more irregular, *ad hoc* basis, according to demand, purpose, circumstances and priority. Whereas many companies, particularly the more sizeable ones, organise a system of regular, standardised reporting, focusing upon such matters as performance, cost control, and marketing success, these matters are among the more backward-looking aspects of management accounting. The more strategic, more important aspects such as deciding upon the items in which to invest, which markets to enter/leave, which products to sell and which processes to adjust tend to be carried out less regularly. Such future-focused management accounting information is produced either according to immediate needs (reaction) or according to a predetermined strategy aimed at optimising organisational performance (proaction).

The *Timeliness* ('time value') of Management Accounting Information

Whichever type of management accounting information is being produced, it is only of value if it is produced within a given period of time. Regularly produced, routine, past-focused information needs to be available within a relatively short period of time after the period under review, in order to be of value in making adjustments to actions in the following period. Similarly, forward-looking, strategically focused management accounting information needs to be produced quickly in order to take advantage of the opportunities that might exist, and before competitors gain the advantage.

There are, however, relationships between the timeliness of management accounting information and other factors such as its accuracy, reliability, comprehensibility and relevance, and the cost of producing it.

The Role, Power and Responsibilities of the Management Accountant

As described in the preceding section, management accounting, and management accountants, may be in a position to have a significant influence upon the actions and strategies of organisations. With this potential influence comes the burden of ensuring that management accounting information is generated and communicated in a responsible fashion. Consider some examples of the outcomes of decisions made upon the basis of faulty or unreliable management accounting information:

- Employees may be labelled as inefficient, lazy or unsuitable and, as a result, may be subject to financial penalties or the loss of their livelihoods.
- A branch, division or department of an organisation may be labelled as ineffective or uncompetitive, resulting in the demotivation of its workforce and possibly its closure.
- Scarce financial resources may be diverted into investment projects that are unfeasible, or suboptimal, leading to adverse effects on organisational results.
- A company might decide to alter the mix of products that it produces, or to alter the geographical focus of its marketing, leading to a disastrous downturn in profitability and share price.
- A local health authority may decide to alter the range of procedures that its hospitals provide, or to close a local hospital, on false grounds, to the detriment of local health provision.
- A government department may decide to close down a service department and to use external, private sector contractors to provide the service, possibly leading to a poorer, less reliable service and escalating future costs.
- An incomplete analysis may lead to a company's outsourcing of components or services, only to find that quality and delivery suffer, with consequent effects on competitiveness, and depressing effects on the local economy and employment.

The management accountant's role is thus a responsible one which can have direct effects on people both within and outside of the organisation. As we saw earlier, the management accountant, as the provider of performance-monitoring information, acts as an important and influential link in the chain between management and employees, and between shareholders and management. The relationship between those in a position of 'power' (the *principals*) and those being managed or employed (the *agents*) is known as the *principal-agent* relationship, and the corresponding body of theory is known as *principal-agent theory* or *agency theory*. We will examine such theory in more detail later. It is, however, worth noting here that the management accountant is responsible for ensuring two things in respect of the principal-agent relationship:

- that any information produced to monitor the performance of the agent is as reliable and accurate as possible;
- that any system designed to enable such monitoring is *unbiased*, either in favour of the principal or the agent.

This is not easy to achieve. The management accountant is meant to be a professional, acting in an impartial fashion. At the same time, however, she/he is an employee of the principal and may feel pressure to act in favour of the principal, to the detriment of the agent. Such pressure may be applied in many ways, including the 'carrot' of enhanced remuneration for being a 'company player'. Of course, being in a position to control the destiny of others can bestow a measure of power on the management accountant, and this power must also be handled responsibly and ethically.

Later we will look in more depth at some writers' thoughts on the role of ethics, ethical codes and empowerment/disempowerment in the work of management accountants. This

is an important area of study, as mishandling such matters can lead to the distrust of management accountants and the devaluation of their inputs.

Information Requirements for Management Accounting: Practicalities, Costs and Organisational Implications

An excellent coverage of the information requirements of organisations, for the purposes of planning and control, is given in the first few chapters of Emmanuel *et al.* (1995). Emmanuel *et al.* indicate a number of important considerations of information for planning and control. The following checklist below is based on Emmanuel *et al.* and is intended to act as an overview of some of the issues that should be considered when encountering any management accounting planning/control system:

- Accounting information is affected by the modern business environment. Such environments are characterised by their complexity, uncertainty and turbulence, and therefore management accounting systems must be designed to be able to cope with such environmental conditions.
- Accounting information systems must take account of the nature of control information appropriate to the particular organisation, the methods used for data and information transmission, and the culture and shared values existing within the organisation.
- Information for control may be formal or informal; quantifiable or unquantifiable; routine or *ad hoc*. The system must be designed to be able to produce appropriate control information at appropriate times.
- Accounting information systems serve as a means of control; an integrative mechanism and/or a measure of performance and viability. These multiple uses may conflict and lead to behavioural problems.
- Control is the process by which a system adapts to its environment and may have two major themes; one as a means to achieving the end of domination, and the other as a form of regulation (regulation of others or self-regulation).
- To achieve self-regulation, clear objectives are required – an internal means of achieving these objectives by measurable outputs and a predictive model of output. Any effective management control system must possess each of these. Self-regulating systems are sometimes called *cybernetic* systems.
- Control involves consideration of both operational and strategic issues and goes ‘hand in hand’ with planning.
- Feedback is important. There are two important terms; (i) *negative feedback* is where control action is taken to reduce deviations from the plan; and (ii) *feed-forward* is the comparison of expected outputs (predictions) with future activities, and control activities implemented. Planning is a form of feed-forward control.

- Decisions take two forms: *programmed*, where the situation is understood enough to make reliable predictions and *unprogrammed*, where no formal mechanism for prediction exists. It can be argued that a flaw of many management accounting models is that they assume programmed situations where many actual management control situations are unprogrammed in nature.
- Objectives: Emmanuel *et al.* suggest that ‘individuals have objectives – collectivities do not’. One of the practical problems of designing, implementing and maintaining management control systems is that reconciling individual objectives and (assumed) group objectives may be problematic. Agreement on objectives is necessary for groups to hold together
- Some main aspects for comparison of performance, that is, performance measurement, are: current period vs. previous periods; comparisons with similar organisations; actual vs. estimates (either *ex ante* or *ex post* estimates); actual performance vs. benchmarks or necessary performance required measured against specified objectives; and so on.
- There is no ‘best way’ to manage an organisation, including its management control systems. Everything is contingent upon a range of factors such as the environment (its predictability; competition; product diversity; hostility and so on); organisational structure (its size, interdependencies, level of decentralisation, resource availability); and technology (nature of processes, degree of routine, clarity of causal relationships). Thus improving control systems is a continuing and iterative process requiring an enquiring mind, flexibility and an openness to change.
- Managers are limited in their capabilities in many ways. They have, for example, limited powers of understanding, a limited capability to deal with a lot of data at once and limited rationality. So, rather than undertake a full and logical appraisal of decisions (which is impossible in the practical situation) managers may jump at the first acceptable solution.
- Management control may take place at a number of levels:
 - (i) *strategic planning* – information should be tailor-made, external and predictive;
 - (ii) *management control* – information should be integrated, mainly internal and more historical;
 - (iii) *task/operational control* – information should be tailor-made, internal and real-time.

Emmanuel *et al.* conclude that the ideal conditions for effective control systems are:

- a stable operating environment;
- a clear-cut organisational hierarchy;
- clear definitions of controllability;
- little interdependence between parts of the organisation.

Of course, in today’s large, complex multinational organisations operating within an extremely competitive global marketplace, conditions are less than ideal to make life easy for the management accountant!

Conclusions

This chapter has shown that management accounting:

- is essentially the production of information for managers at all levels;
- is designed to increase organisational effectiveness;
- is forward-looking and relies upon estimation;
- has evolved and continues to evolve as organisations and society progress.

It has also argued that management accounting information:

- must be relevant to be useful and so must take account of organisational and behavioural settings;
- may have undesirable effects if used without careful consideration

Summary

This chapter has provided an introduction to the nature, scope and difficulties of management accounting. We have seen that management accounting is forward-looking in nature and is involved in assessing the implications of managerial and strategic decisions, both those decisions made in the past and those being considered at present. Essentially, we see management accounting as being interested in producing useful information to enhance organisational effectiveness.

The role of management accounting, and the definition of its scope, continues to evolve. We have seen that management accounting information is essential to most organisational players. We have also seen, however, that some management accountants must consider the effects of the information that they produce, as such information may have undesirable effects. Management accounting has an important role to play in all types of organisation, but what type of information is most useful depends upon a wide range of (contingent) factors. Finally, we note that management accounting may play a passive, reactive role or an active one. The latter approach carries with it a degree of responsibility for the organisational and possibly societal impacts it may have.

Recommended Further Reading

Loft, A. (1995) 'The history of management accounting', in D. Ashton, T. Hopper and R. Scapens (eds), *Issues in Management Accounting* (2nd edition). Hemel Hempstead: Prentice Hall.

Loft gives an overview of the history of management accounting, looking at the various (often conflicting) historical perspectives. Such analyses can be useful in learning from the past when negotiating current and future management accounting problems. She points to some of the problems of any historical analysis:

- the possible atypicality of early examples;
- a lack of clear evidence of how accounting records were used, and to what extent.

Loft identifies four ‘schools of thought’ in the history of management accounting:

Traditional School and the Neo-classical Revision

Loft explains how, as a result of the Great Depression of the late nineteenth century, there was a crucial need to calculate and be aware of product costs as competition increased. This led, she notes, to the emergence of systematic allocations, apportionment and cost/financial integration (she refers to *Factory Accounts*, by Garke and Fells (1887), in this respect). She further explains how following the nineteenth century there was a development of ideas regarding allocation to products, accounting for waste and scrap, and how standard costing methods emerged in the 1920s. Within the ‘traditional’ school, she explains that costing is seen as a manufacturer’s tool that developed in line with manufacturing methods.

‘Neo-classical revision’ was, Loft observes, a similar view to that of the traditional school except it argues that *costing was a management tool as early as the late eighteenth century* and that costing methods were used to maximise profits and defend against competition. Loft mentions the work of Fleischman, Parker and Tyson as being representative of the views of the neo-classical revisionists.

In both traditional and neo-classical views, management accounting is seen as taking a *very passive and reactive* role.

‘Relevance lost’ school

Loft refers to Johnson and Kaplan (1991), who say that in 1962 Alfred Chandler drew attention to the importance of management accounting in the development of giant US firms. Management accounting is seen to have been a key factor in co-ordinating such firms’ wide activity ranges over large geographical areas. Johnson and Kaplan argue that:

- it was the rise of the factory that led to a move away from market-exchange structures (lots of small traders/manufacturers letting the market dictate prices).
- management accounting/costing was a necessary tool of the new industrial capitalism of the late nineteenth century, developing to ‘evaluate a company’s internal processes’ via measuring efficiency in mainly singler activity firms.
- management accounting’s development *facilitated* the growth of enterprises – i.e. it was *proactive* rather than passive; a *catalyst to change* rather than an effect of it.
- as scientific management (Taylorism) developed, management accounting moved from simple records of cost (historic) into budgeting and monitoring, and financial accountants found that it was useful for simple-evaluation of stocks.
- following the turn of the twentieth century, as firms became larger and more decentralised, further management accounting measures (e.g. return on investment (ROI))

led to an increase in management accounting's role, in order to optimise the use of capital.

- most 'modern' management accounting practices had been developed by 1925 and managers have since tended to rely mainly on numbers. Therefore, management accounting's information content has lost its strategic (and sometimes most of its) relevance.

Loft points out that, although management accounting may have been slow to react to change, it was 'catching up' and that the preferred process was one of evolution rather than revolution – i.e. a series of gradual well-considered changes rather than 'fire-fighting' reactions. Although some of management accounting's key techniques and approaches were admittedly quite well established (i.e. old), this did not necessarily lessen their relevance (after all, some of the basic principles of mathematics and language, for example, have very historic origins, but they still apply today).

Labour Process Approach

Loft refers to the work of Hopper and Armstrong (1991) who:

- see management accounting's development as being one (significant) aspect of overall changes in the way in which the labour process has been controlled as capitalists have progressively alienated the process of production from the worker.
- explain the success of early factories (partly) by the way in *which management accounting was used to intensify the exploitation of labour*.
- interpret management accounting's focus in the early twentieth century as one of *reducing the power of the labour force, rather than of increasing productive efficiency*
- explain that, in order to homogenise labour via de-skilling, companies increased the percentage of unskilled labour used by reorganising the productive process. Management accounting developed rapidly in order to aid this process.
- see budgeting and the use of ROI as having been developed to increase control over managerial labour and hence, again, management accounting is interpreted as a tool used in this process of exploitation.

All of the above may explain the dominance, in the twentieth century, of accountants as senior executives in most US and UK organisations – i.e. accountants as a *dominating* force; engineers and the like as dominated managerial labour).

Radicalism

Loft explains how the writing of Foucault, Derrida and others (none of whom wrote directly about accounting) may be used to help in the interpretation of management accounting's history. Foucault (1977) wrote about the growth of disciplinary institutions (prisons, armies, schools, hospitals, *factories*) in the nineteenth and twentieth centuries, wherein individuals were arranged so that they could be watched, and discipline/punishment administered, via surveillance and record keeping.

Management accounting can thus be seen as one of these techniques of surveillance and record keeping. Such a process will lead to the prioritisation of financial factors above all others, and hence to the expansion of management accounting.

Loft points to the effects of the UK government's taking control of many factories during the world wars of the twentieth century. This led to the dominance of cost-plus pricing and a much-increased emphasis of historical costing. Therefore cost accounting expanded, as did the cost accountant's importance.

Management accounting is thus seen as part of the process of creating the 'governable person'.

Questions

1. Examine the extent to which the role and nature of management accountants might differ within the public and private sectors.
2. Critically analyse the possible effects of e-commerce on the role of the management accountant.
3. Traditionally, management accounting, financial management and financial accounting have been treated as largely separate disciplines. Discuss the extent to which such a categorisation is still valid and comment upon the implications for today's management accounting profession.
4. 'Management accountants exist to ensure that the changing information needs of managers are met.'
 'Management accountants are in the fortunate position of being the brokers and guardians of information. They may use this information to increase their own power and status.'
 'Management accountants have a duty to serve all stakeholders of their organisation and a responsibility to ensure the reliability of the information which they process.'
 To what extent are these statements contradictory or complementary?
5. Analyse the potential effects of recent developments in the business *or* public sector environments on the relevance of management accounting systems.
6. Analyse the extent to which the management accounting information system of a service-based organisation of your choice would be likely to differ from that of a manufacturing company.