

Accountability
representation control
three pillars of
organizational
efficiency



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Accountability, representation and control are often perceived as the three different entities; however, they are three interconnected topics which form the base of the organization. They function on the various aspects of the accounting which is a diversified field and can be studied under these three heads in more detail. I have tried to illuminate the major aspect of all these three topics with respect to accounting and then how these issues are applied in the recent economic debacle. To begin with first I would like to bring the notion of accountability and then representation and then control and lastly, the recent financial failures.

Accountability: An Introduction

“ Accountability breeds responsibility”. This famous quote by Steven R. Covey gives the meaning of accountability in rather general terms. The concept of accountability can be defined as the process through which a person is held answerable for his actions and deeds.. Under the umbrella of the organization the notion of accountability can be stated as the phenomenon through which whether a person at the higher level of hierarchy or at the lower level is accountable for his works and services that he renders to the organization. Accountability from the organizational perspective bears great importance as it is the measure through which the performance of the organization and a person serving can be judged and analysed. Accountability has different forms which can be studied and understood by the findings of John Roberts (1991). He tries to explore different contemporary forms of the accountability and the possibilities in which accounting can be perceived. First, the individualising form of accountability can be studied in which the accountability contributes in

making the realization of the image an individual perceives about it. (John Roberts, Page No. 358, 1991). This perspective helps a person to polish his senses and action thereby improving his image that is noticed by others. Second view of accountability that Roberts illustrates is the socialising form in which a person can improve its performance and efficiency by interacting with some of the experienced people in the organization. Accountability institutionalizes the use of accounting through which it operates in the organizations and firms.

How Accountability Works?

Accountability within the organizations mainly works through three different levels of accounting. They are auditing, management accounting and financial reporting (Lightfoot, 2009 Accountability, 2009 Available on https://blackboard.le.ac.uk/webapps/portal/frameset.jsp?tab_id=_2_1&url=%2Fwebapps%2Fblackboard%2Fexecute%2Flauncher%3Ftype%3DCourse%26id%3D_3872_1%26url%3D). Financial reporting and management accounting aspect of accounting has been dealt in detail in representation and control part respectively. The third and more applicative form in which accountability holds in the organizations is the auditing in which companies accounts are checked and verified by some agency or authority assigned for it is covered in detail here. When it comes to organizational perspective the application of accountability expands. From the past there has been a practice in business and organizations to maintain the accounts of each and every transaction that takes place in the organization. In modern era this system has become more advanced and transparent. The organizations can be judged or held responsible

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economically on the grounds of the accounts or financial statements that they produce. This involves the concept of auditing of company accounts.

Audit serves “ as a vital economic process and play an important role in serving the public interest by strengthening the accountability and

reinforcing the trust and confidence in financial reporting” ((Available on <http://www.icaew.com/index>.

http://www.icaew.com/index.cfm/route/139474/icaew_ga/Technical_and_Business_Topics/Thought_leadership/Audit_Quality_Forum/Agency_theory_and_the_role_of_audit/pdf, 2005) ,

2005). Auditing of accounts are generally performed by the people employed by the owner of the company, these persons are called auditors, agents or

stewards. They generally work in the interest of the company with focus on the economic performance of the institution. This phenomenon is called as

agency theory which suggests that because of the information asymmetries people employ agents or stewards who works for the benefit of the company.

Auditing gives a clear idea of accounts and also imparts the correct

information to the shareholders. In UK, the auditing system was enforced after the application of Company Law Act 1985 where each and every

registered company were supposed to produce an annual audit. (Available on <http://www.icaew.com/index>.

http://www.icaew.com/index.cfm/route/139474/icaew_ga/Technical_and_Business_Topics/Thought_leadership/Audit_Quality_Forum/Agency_theory_and_the_role_of_audit/pdf, 2005) .

Interplay between Accounting and Accountability

Accounting can be defined as “ the process of identifying, measuring and communicating the financial information about the entity to permit informed judgments and decisions by users of information”. (American Accounting

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Association as quoted in Atrill and McLane , Page No. 5, 2002). Initially there were cruder forms of accounting first one was double entry system which was a binary system method used for recording the events in which all the debits and credits were represented in the tabular form and the second was bookkeeping which was the maintenance or the summary of all the financial transactions taken place.(Arizona, 2001). Accountability often comes to play where there is some accounting failures or discrepancies and the company or the person producing the account is held responsible.

Historical perspective of Accounting

The topic of emergence of accounting and some other new fields in accounting which has helped in making the inefficiencies of the individual visible and thus holding them responsible using the techniques of accounting viz standard costing and budgeting. Moreover, the authors have underpinned the notion of improving the individual performance by using these forms of accounting that emerged over the years. The studies of the accounting past reveal that the concept of accounting has changed over the years as per the nature and the requirement of the changing business scenario (Miller and O'Leary 1987). One advantage of studying the concept of accounting from historical perspective is that a person can analyse where the accounting concept went in discord with respect to the demanding environment and these views can be elucidated and worked out at present.

Representation an Overview

Representation from the purview of accounting can be further studied as financial accounting is an important branch of accounting which deals with the accounting outside the organization as company . This comes under the <https://assignbuster.com/accountability-representation-control-three-pillars-of-organizational-efficiency/>

financial aspect of accounting. Financial statements or reports can be defined as "... the [tool] which provide a picture of the financial position and performance of the business". (Atrill and Mclaney, 2008: Pg No. 38) There are various objectives of producing financial statements such as informing the investors or creditors about the current positioning of the company, to keep a record of all the economic transactions taking place within the company, to help managers in taking decisions etc. (Lightfoot, Chapter No. 7 Representing accounting 2009). There are three forms of financial statements produced viz. cash flow which is the net movement of the cash taking place over a period of time often referred to as the difference of cash in and cash out (Atrill and Mclaney, 2008; Geoffrey Lightfoot Chapter 2 Representation of accounts and representation of theories of accounting. , 2009), the income statement which is also called as profit and loss statement and is the statement of sales and related costs (Atrill and Mclaney, 2008; Geoffrey Lightfoot, 2009) and finally the balance sheet which is the amount of assets and amount owed externally (Geoffrey Lightfoot, Chapter 2 Representation of Accounts and representation of theories of accounting : PageNo 5). All three aspects form the basis of the financial reporting of the organization. These are the methods which every company follows while producing their financial statements.

Uses of Accounting: Creative accounting

Companies often use these in a fraudulent way to produce accounts. These kinds of accounts are called as creative accounts and the practice is called creative accounting (Atrill and Mclaney, 2008). It can be defined in a more specific way as "...the alteration in the accounting rules that raises concerns

over the quality of published financial statements that is in line with what company wants others to see rather than what is fair and true regarding the financial position and performance". (Atrill and McLaney, 2008). There are mainly four methods of creative accounting which an organization can adopt. First, is the overstating revenues in which companies tend to exaggerate the revenues (total amount of money that a company receives by selling off goods or providing services). This is a core issue reported in many of the recent financial failures. Second is the massaging expense in which the directors handle the future costs of assets (anything that can furnish the money in the present or future; it can be tangible or intangible) skilfully which can in return make it possible to derive a consistent profit figures in the future. Third is the hiding or concealing of any losses or liabilities(help to make financial statements look in a great position. There has been a number of instances in the past of organization that this form of creative accounting has been adopted by the companies such as Enron Corporation failure was mainly because of this where they tried to hide their falling assets values (Atrill and McLaney, 2008: Pg No. 183). The notion was to represent the company accounts statements in a falsified way so that it may look healthier. Lastly, it can be overstating assets which are projecting the high values of asset than the fair market value which is again a spurious method of accounting. These practices are very much reported in the companies in recent past. But the major roll back in the history of accounting came after the Enron failure broke out in the year 2001 which caused the investors to lose money, a law was passed in the US in the year 2002 called the Sarbanes and Oxley Act (SOX) whose main objective is safeguarding the interest of the investors by completely revolutionising the financial reporting system (Ritto, <https://assignbuster.com/accountability-representation-control-three-pillars-of-organizational-efficiency/>)

2008). This law helps in keeping a check on the recording derivatives (that derive their value from the underlying assets) transactions. (Cunningham, 2006: 40) Key feature used by Enron Company to forge its accounts.

Furthermore, many of these topics have been argued by a number of authors who have studied these topics in detail and have drawn various inferences (Chwastiak and Young 2005; McSweeney1997). McSweeney has tried to focus on the authenticity of the financial reports that a company produces and termed it as “ representational faithfulness” (McSweeney1997). These authors suggest that there are various conditions in which these financial reports cannot be trusted. McSweeney(1997) analysed two texts derived from US Financial Accounts Standards Board’s statement of financial accounting concept No. 2: qualitative characteristic of accounting information(1980), and Tom Lee’s Cash Flow accounting(1984). (McSweeney1997: Pg No 694). In both of these texts McSweeney tried to reiterate that the representational faithfulness can be achieved only if the financial reports that are published should match with the economic transaction, events and circumstances that it purports (McSweeney1997: Pg No 695). Moreover, he argues that the representational faithfulness depends upon how well informed the reader is, if the reader has all the information then he can judge the authenticity and faithfulness of the representation himself. In addition to that he also gives the notion that the representation may be imprecise or in other words the accounting representations cannot always be accurate, it may vary but the question here is how much this variance must be considered. McSweeney affirms that impression can be a consequence of choice or to be unavoidable(McSweeney1997: page no 697).

However, later on in the article when he studies the second text of Tom Lee <https://assignbuster.com/accountability-representation-control-three-pillars-of-organizational-efficiency/>

in which Lee suggests that the Cash flow accounting can be a solution which offers accurate financial reporting without ambiguities.

However, there are some authors who remain cynical in approach when it comes to discussing the annual reports that the companies produce (Chwastiak and Young, 2005). They suggest that companies often do not care when it comes to projecting the profit maximisation in the annual reports. The financial reports are regarded as the dominant discourses which are always concerned to depict the profit maximisation without considering any other aspects like the earth hazards, human and animal hazards etc. He name these practices silencing of injustices (Chwastiak and Young, 2005; Page No. 534).

Control

Control can be defined as the method by which something is monitored or dominated. From organizational perspective the concept of control involves management accounting which is the branch of the accounting that deals with the nuances of management in the companies. It involves the notion of corporate governance which includes all the processes used to gain control over a firm. Control involves mainly two key features viz. future planning and decision making. Control can be accessed by the managers who have the related expertise in the relevant field however, Armstrong investigates that there has been a change in the recent management system which contradicts with the findings of the F J Taylor of scientific management which opines that the managers often have related experience in their relevant field and also Henri Foyal who also strengthens this view (Armstrong, 2001).

However, he further suggests the techniques in management system that <https://assignbuster.com/accountability-representation-control-three-pillars-of-organizational-efficiency/>

completely revives the management system covered in detail in latter part of the essay.

Means and Measures of Control

There are mainly two ways through which organizational control can be achieved. First is the budgeting and the other one is cost accounting.

Budget Control

Often control in the companies is achieved through proper future planning. This involves the budgeting where the future planning regarding the budgets of the companies are predicted and calculated and then the variances from the calculated performance and actual performance is calculated (Atrill and McLaney, 2008). As budgets are a sort of representation we can see the amalgamation of both the fields that is representation and control in one field. The main aims of budgeting are the monitoring variance, synchronization of activities in the organization, planning resource allocation (Geoffrey Lightfoot, Chapter4 Management Control and Control of Management 2009). Additionally, it also helps in the judgment of manager's performance where it serves both as the measure of accountability and control as well (Geoffrey Lighfoot, Chapter 5 Management Control and Labour Processes 2009) Managers are also involved in the process of risk management where they can be held accountable in predicting the difference between the prepared budget and the variances. This is an important factor of failure of financial institutions. Budgetary control pattern can be further studies under two control systems:

Feedback control system:- In this system first the budget is prepared and then the comparison between the actual performance and the prepared budgetary performance are juxtaposed and then the third step is the response to the variances and exercising control. It is a very useful measure by which the senior level management exercise the control and accountability over the junior level of managers in their budget preparation therefore, pressing towards the objectives of the business(Atrill and McLaney, 2008; Glautier and Underdeum, 2001).

Feedforward control system:- In this system anticipations are made as to where the prepared budget can go wrong. In this type of forecasting practice it is possible to know the short comings of the prepared budget and then actions would be taken on those areas and improved budget can be prepared (Atrill and McLaney, 2008; Glautier and Underdeum , 2001).

Activating based costing method (ABCM)

This is another method which serves as a measure of planning and control. This involves the allotment of the costs and the services. This was formulated as a measure to revamp the obsolete process of the cost management system that involves the inefficiency of specifically predicting the production and services costs or convey the useful information for decisions. This is again an area where the concept of control and accountability is related as the manager's performance can be measured based on the decision making of inaccurate data. (Glautier and Underdeum, 2001). This is the technique that Armstrong consider in his paper as a modelling process which was developed to curb the inaccuracy of the

previous accounting systems which comprises of single allocation base to the overheads costs.(Armstrong, 2001).

Senses of Control

Senses of control imply various factors which can affect the organization working and its performance. It can be distributed into two fields viz. internal control or management control which are the process formulated to convey the reasonable assurance as regards to the attainment of the objectives of the organizations and external control (Cunningham, 2006). These can be further classified in to two categories. They are as follows:

Bureaucratic Control:- It refers to the usage reward, policies and rules that augments the performance of the employees in the organization. (Available on <http://www.strategic-control.24xls.com/en112> accessed on 09. 12. 2009)

Clan Control:- It implies the use of the informal measures to enhance the efficiency of the employees working in the organization. (Available on <http://www.strategic-control.24xls.com/en112> accessed on 09. 12. 2009)

The second type of control mechanism is external control in which the functioning of the organization is affected by some external factors. This involves market control process which employs the usage of price competition to judge the outputs. For market control system to operate there must be a reasonable degree of competition in goods or services it should be possible to clearly mention the requirements. (Barnat, 2005).

Financial Institution failure

All the three issues that we have discussed are the major factors which comes into play in the recent collapse of financial institution. Financial crunch or the recession of 2008 was mainly due to the failure of financial institutions. A financial institution can be defined as an institution which provides financial services to its clients. The recent failure of market was mainly caused due to the fall of Lehman's brother which was global financial player and dealt in a range of financial services like investment banking, fixed income sales, research and trading. It was in the month of September 2008 that it filed for bankruptcy with \$639 billion assets and \$619 billion in debt, its bankruptcy surpassed all the other reported bankruptcy like that of Enron and World. com.(<http://www. investopedia.com/articles/economics/09/lehman-brothers-collapse. asp? viewed= 1, 2009>). The reason of the failure of Lehman brothers was that during the economy boom time in US in the year 2005, it owned a stake in the ownership of five mortgagers (acquired) including some of those who had tarnished image of credit history such as BNC mortgage, and Aurora Loan services, which were major subprime lenders at the same time Lehman also reported a record high of revenue earnings in the previous years enabled it to mount the profit rate 56% from 2004 to 2006. After the credit crisis broke out in 2007, it continued to its policy of lend more money in acquisition (Mortgage back securities) in order to boost up more profits. But due to credit crunch Lehman brother had to suffer losses(<http://www. investopedia.com/articles/economics/09/lehman-brothers-collapse. asp? viewed= 1, 2009>). It was here that the higher managerial authorities must have been held accountable. The argument of Chwastiak and Young seems relevant <https://assignbuster.com/accountability-representation-control-three-pillars-of-organizational-efficiency/>

[com/articles/economics/09/lehman-brothers-collapse. asp? viewed= 1, 2009](http://www. investopedia.com/articles/economics/09/lehman-brothers-collapse. asp? viewed= 1, 2009)). The reason of the failure of Lehman brothers was that during the economy boom time in US in the year 2005, it owned a stake in the ownership of five mortgagers (acquired) including some of those who had tarnished image of credit history such as BNC mortgage, and Aurora Loan services, which were major subprime lenders at the same time Lehman also reported a record high of revenue earnings in the previous years enabled it to mount the profit rate 56% from 2004 to 2006. After the credit crisis broke out in 2007, it continued to its policy of lend more money in acquisition (Mortgage back securities) in order to boost up more profits. But due to credit crunch Lehman brother had to suffer losses(<http://www. investopedia.com/articles/economics/09/lehman-brothers-collapse. asp? viewed= 1, 2009>). It was here that the higher managerial authorities must have been held accountable. The argument of Chwastiak and Young seems relevant <https://assignbuster.com/accountability-representation-control-three-pillars-of-organizational-efficiency/>

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here that the financial entities are only concerned with the profit maximization. Secondly, the second factor of failure of Lehman brothers its high leverages value (usage of debt to fortify the investment in order to maximise the profit (loss)) ([http://www.investopedia.com/articles/economics/09/lehman-brothers-collapse.asp?viewed= 1, 2009](http://www.investopedia.com/articles/economics/09/lehman-brothers-collapse.asp?viewed=1,2009))). Here the problem with the recording derivatives can be seen in which the Lehman failed. The third factor was the risk management failure in which the senior management failed in assessing the risk of the future and therefore, failed from the internal control perspective. Besides this there are other examples also like the failure of Merrill Lynch, Arthur Andersen etc. that failed to comply with the three issues viz accountability, representation and control.

These three topics are very vital in respect to the organizations as it forms the three pillars on which the functioning of an organization is based. However, often these issues are overlooked and the companies suffer losses and eventually market collapses thereby undermining the public interest. However, after the recent failures and crisis the governments have taken up controls over economy in the recession hit countries and are trying to revive the global market scenarios. Nonetheless, it cannot be achieved until these issues are strictly considered with compliance.