

# Modern management accounting



**ASSIGN  
BUSTER**

*A) “ Critically discuss the role of modern management accounting, and the extent to which it shapes, or is shaped by, the changing organizational and global context within which it is practiced”.*

*B) “ With reference to relevant literature, critically evaluate the effectiveness of Three recent developments in management accounting techniques, within specific organizational or national contexts of your choice (e. g. Manufacturing or Service Sectors, Advanced or Emerging Economies)”.*

### **1) Introduction.**

Over the last two decades, management accounting developed as a practical aid to business managers and as a subject for academic teaching and research (Robert W. S, 1993). Management accounting thus explains that “ It is the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information” (Drury, 2009: 3). Management accounting plays a very important role, where in which it gives the manager sufficient time and relevant information and set targets, monitor performance and systematically improve the efficiency and effectiveness of the organizations in meeting its objectives consistently and adds value by creating operations and process within the organization (Prit, 2009).

To bring our history of management accounting up to date, developments since 1975 have recognized that an information and reporting system has an effect on individuals (Robert S. Kaplan, 1982). Although the management accounting has developed in the fourteenth century, with principles of financial accounting and bookkeeping, management accounting was not practiced by the merchants and small business owners prior to the industrial

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revolution. It was then in the nineteenth century the new accounting methods were developed because entrepreneurs were beginning to hire people on a long-term basis, to make capital investments, and introduce more complex production technologies (Brain H. Maskell, 1996).

With referring to the relevant literature, there have been few recent developments in management accounting techniques within manufacturing and service sectors. The practice of modern management accounting is different from traditional accounting. The recent developments enables managers to make sound decisions to minimize cost as well as in the same time it adds value to the products and services by improving the quality of products, which is required by the customers and reduce waste ( Prit, 2009).

However, the pendulum swung in the other direction over the next decade as an effect of new “ Techniques” in management accounting area. Activity-based-costing (ABC), Just-in-time (JIT), Total-quality-management (TQM) have been developed to update the traditional accounting model so it adequately reflects today’s manufacturing environment (Seed, Allen H, 1990).

## **2) Modern Management Accounting:**

### **2. 1: Role of management accounting.**

The relation between accounting and management has been commonly expressed by the phrase, “ Accounting is a tool of management”. Accounting practice has developed in response to a changing business economy. In view of these changes, effects have been made to clarify, redefine, and seek acceptance of accounting doctrine and practice (Coleman R W, 1949).

Management accounting systems (MAS) are recognized as providing a most important source of journal information in organizations, a source of power deriving from the possession of that information, and a means for distributing that power and of managing the organizational system (C S Jones, 1995).

The direct impact of organizational changes to different role of management accounting is difficult to measure. The changing role of management accounting becomes evident through sub-stantiate of management accounting (Loreta Valanciene, Edita Gimzauskiene, 2007). (Paul weetman 2000) Pointed out that the role of management accounting consists of,

Direct attention: means providing full information to the specific situations e. g. Where the problem occurs, who creates a loss. In the high competitive market, this role alerts the manager about competitor's information such as their strategy, new product.

### **Keeping the score:**

This role aims to answer the questions: how much and how many. (How much implies to those things is related allocation and the share of costs within the whole organisation, and how many refers to the quantity of inputs will be used). In the strategic management, the answer to those questions may be extending such as how much the market share, how many compared to the competitors.

### **Solving the problems:**

The management accounting is a good channelize for manager to provide the nearest relevant methods for solving the subsisting problems. Due to

M/A , the manager can collect all detailed information about the problems such as which causes it, when it starts, and then based on those information, several answers will be provided and the task of manager is to choose the most appropriate one ( Paul Weetman, 2000).

## **2. 2: Comparison of Traditional and Modern management accounting:**

During the 1950s and 1960s, accountants gradually discovered that product costs, which had been constructed for financial reporting purposes, were being taken seriously by operating executives. In the late 1960s and early 1970s, the management accounting thought developed that attempted to subsume the two previous approaches into a boarder conceptual framework (Robert S. Kaplan, 1982).

Historical and contemporary studies of accounting have shed light on the diverse ways in which accounting has been and is been implicated in a wide range of activities and social arrangements (Hopwood and Miller, 1994).

Accounting cannot be understood simply with reference to its supposed functional properties because it is implicated in the shaping of its own context (Thomas Ahrens, and Christopher S. Chapman, 2007).

This said, much of the evidence to date suggests that, in practice, traditional management accounting techniques remain popular (Dury et al., 1993).

However, it appears also that such traditional techniques are being used alongside new and ‘ advanced’ accounting techniques, such as ABC, JIT and TQM (J Burns and J Vaivio, 2001).

Management accounting is used to help managers make solid business decisions (Laura o, 2009). Because of revolution in management accounting, both smallest corner store and largest multinational organisation start their own innovation on their accounting perspective (Anonymous, 2004).

Successful organisations adapt to changes in their environment and proactively change their environment. Management accounting should help organisations recognize the need for initiating change and suggest the appropriate response to an environment change (Anthony A. Atkinson, et al 1997).

### **2. 3: Change in Global/ Organisational context and management accounting:**

Since 1975 important changes have taken place in the context of political, economic and social settings (Joan Amat, Salvador Carmona and Hanno Roberts, 1994). The management accounting faces few challenges over environmental changes as well as internal process within organisations. Therefore, management accounting, must response to these changes by adapting new techniques and concepts (Wickramasinghe and Alwattage, 2007).

#### **The measurement of costs:**

By using the modern management techniques, the value and profitability of information services can be generated (M S Magson, 1973).

#### **The birth of “ hybrid” accountants:**

As a result of new forms of organisations and requirements of strategic management accounting (SMA). SMA links performance measurement

system with corporate vision and strategies (Wickramasinghe and Alwattage, 2007).

### **Open-book accounting:**

These techniques are important part of outcome control measurement for companies in inter-organisational relationships, which are another result of increased globalization (Hopper, 2007: 276).

In discussing the nature of settled habits of thought and action Hodgson, (1993 b) defined habits as more or less self-actualizing dispositions or tendencies to engage in previously adopted or acquired form of action (John Burns and Robert W. Scapens, 2000).

A strategy of change provides a critical appraisal of current ideas about ‘organizational culture’, ‘total quality management’, ‘flexibility’, and ‘excellence’. Dealing is an integrated way with the full spectrum of survival in today’s changing environment (David C. Wilson, 1992).

### **3: Management accounting techniques:**

#### **3. 1: Characteristics of manufacturing and service sectors:**

Much of the literature on international business has taken on a manufacturing perspective. The recent literature has paid attention to the internationalization of service firms (Peter et. al., 1999).

Characteristics of service production.

- Intangible output.
- Customised output.

- Labour intensive.

#### Manufacturing Orientations in Service firms.

- Physical goods as a component as a service package (Fitzsimmons and Sullivan, 1982; Sasser et al, 1978).
- Manufacturing logic in back-office service operations (Chase, 1978).
- Deprofessionalization of service production and delivery (Northcraft and Chase, 1985).

#### Service Orientations in Manufacturing Firms.

- Component of the product (e. g., Gilmour, 1982, Lele, 1986; Levitt, 1969).
- Element of product strategy (Buzzell and Gale, 1987; Lele, 1986; Porter, 1980)

#### Characteristics of manufacturing production.

- Tangible output.
- Standardized output.
- Technical care buffered from the customer.

The conflict between manufacturing and service sectors. The centre box exhibits orientations among manufacturing and service sectors. The right box exhibits the features of the manufacturing firms and the left box exhibits the features of the service firms. (David et al., 1989). Manufacturing firms, particularly those with diversified product lines, have a good deal more



flexibility and control than extractive investors; they may be able to exercise considerable choice in their response to host country demands (Stephen J, 1987). The continued growth of service sectors in almost all the developing economies has fascinated and occasionally alarmed economists and other observers. Why is the problem more serious in some of the service sectors? Partly it is a data problem, importantly, it is a conceptual one (Zvi G, 1992). Both manufacturing and service company managers need operational control systems that will enhance the cost-improvement, quality-improvement, and process-time reduction activities of their employees (Anthony A. Atkinson; Rajiv D. Banker; Robert S. Kaplan; s. Mark Young, 1997).

### **3. 2: Three techniques:**

#### **3. 2. 1: Activity Based Costing (ABC):**

“ Activity – based costing in a method that is projected to provide managers on cost information for strategic and other conclusions that potentially affect the capacity and therefore ‘ fixed’ costs” (Ray et al. 2000: 322).

Benefits related to activity –based costing (ABC) are many. In ABC, the aim is to understand the overhead and profitability of the products and customers (Garrism and Eric, 2000). ABC works mainly in the large cost drivers related with a decision to be sure of or a process being studied (Wiley, 2001).

In developing countries, the manufacturing industries started adopting new techniques, to maintain relationship between the market development and technological innovation to archive the long-term success. Seemingly, ABC developed as an accounting technique to provide applicable information for

advanced manufacturing firms producing various products in a competitive environment (N. M. Panda, 1999).

Whilst the thoughtfulness, ABC as yet focused on manufacturing firms, ABC can be useful to few service organizations. There are few very disputes among manufacturing and service sectors. Manufacturing firms execute the similar type of activities; however, there is a slight similarity among the activities of an insurance firm, a hospital and law firms. Service sector is less tangible and, harder to define (Glautier and Underdown, 2001).

In developed countries like UK, when the survey of ABC took place for nearly 1000 companies, the result indicated that even after adopting ABC, it has been rejected by a healthy number, and majority of the companies have to still take a decision on its use (John and Mitchell, 1995).

As cost driver and ABC concepts improve the measurement of costs and allocation information for service departments within manufacturing firms, service firms such as accounting/law firm could also use cost driver and ABC concepts (Pirrong, 1993).

### **3. 2. 2: Just-In-Time (JIT):**

“ JIT is a process which is capable of instant response to demand without the need for any overstocking, either in exception of the demand being forthcoming or as a result of inefficiencies in the process” (David Hutchins, 1999). Under certain circumstances of JIT concept, a company maneuvering a JIT system would buy only enough raw materials each day to meet that day’s need. (Ray et al, 2000).

JIT manufacturing scheme calls for making a good or service only when the customer, internal or external needs it. JIT manufacturing is simple in theory, however, had to practice it (Anthony A, Atkinson, 1997).” Keeping everyone busy”, is another characteristics of a conventional manufacturing.

JIT have many advantages, for eg, “ An American standard uses cell manufacturing to cut inventories and reduce manufacturing time. The result is a breakthrough in speed. Manufacturing a pump now takes six minutes than two weeks” (Ray et al, 2000).

JIT production process and the manufacturing effectiveness ratio for manufacturing operations, is as applicable to service companies too. Service delivery process is even more important than in manufacturing companies. Eg. In banking industries, for the process of gaining approval for a mortgage on a house that we like to purchase needed 26 days and after applying JIT process they just need 15 min (Kaplan and Norton, 1996).

### **3. 2. 3 : Total Quality Management (TQM):**

“ TQM is the most popular approach to a continuous improvement. Its major characteristics are to focus on serving customers and systematic problem solving team made up of front-line workers”. Few thousands of companies have been involved in TQM and similar programs (Ray et al, 2000).

For a business, the major driving force is the element of competition. Competitiveness of suppliers is determined by the quality of its product or services (John & Peter, 1997) . Most of the manufacturing companies adopts TQM, either is to improve the work atmosphere for the employees, or to help improve the profits of a company. “ Penril Datacomm is a Maryland designer

and producer of data communications equipment. Before TQM the defect rate of the company were high. Applying TQM techniques resulted in an 81% decrease in defects, an 83% decrease in failures and a 73% decrease in first-year warranty repairs” (Ray et al, 2000: 19).

The concept and tools of service began with Thomas Peters and Robert Waterman’s “ In search Of Excellence”, to achieve customer satisfaction, service companies such as Disney Corporation and SAS Airlines adopted TQM (Kenneth et al, 2005). TQM in education as a business, is difficult to