Evolution of management accounting

Business, Management

1. Introduction

Like other disciple of economicscience, management accounting has its own stages of development. These stages represent the condition of economy and the society at the time and how they react to such situations.

In this paper, I am discussing how management accounting has evolved and developed through time and how it interacts with other functions within the organizations. In the final chapter there are also an elaboration regarding the latest issue in management accounting development and its relationship with other functions in an organization. Prior to such elaboration, I will describe briefly the nature of management accounting and how it correlates to other functions in a company.

Management Accounting

II. 1. Definition and Functions of Management Accounting

Management accounting is often defined as a process of identification, measurement, interpretation andcommunicationof information that is useful for managers to plan, control and evaluate their actions within an organization.

In simple terms, people within the management accounting department has a job of providing managers and leaders of a company with the most accurate and useful information to make and evaluate organizational decisions. The following are often mentioned as the strategic functions of management accounting:

- Controlling present activities of the company

- Maximizing the use of corporate resources
- Planning for future actions and strategies
- Evaluating decisions and performances
- Improving communication, internal and externally

(Chong, 1996)

One example of conducting management accounting happens during the decision to adopt new currency Euro. This action refers to planning for future actions and strategies. In order to deal with the use o Euro currency in their financial reporting, Marks and Spencer plc took some times until the government decided to embark on the Euro (Clark, 2001).

According to Paul Smith, Euro project manager for Marks and Spencer, he stated that significant amount of training is required to get the staff ready for the changes. In 2001 alone, the company spent £2 million in the preparation of the Euro. The company produces videos in six different languages in order to ensure that all employees understand what Euro would mean to them.

The preparation of accepting Euro in all outlets of Marks and Spencer is critical since retailers like Marks and Spencer must carry out appropriate moves such as keeping two cash lines going for two months, spending extra cost incurred by the complications in their businesses (euro/national currency conversion, decisions on accepting notes and coins) and doing adjustment to new euro pricing (Béguelin, 2002). Read about Evolution of Job Design

II. 2. Differences between Financial and Management Accounting

As we are aware of it, there are actually two branches of accounting, managerial accounting and financial accounting. The presence of these two accounting dimensions is the result of what we know as the dual role of accounting. Practitioners have long identified that there are two roles of accounting, which is to provide trustworthy information for external parties and to provide useful insights for internal management. There are apparent differences between management accounting and financial accounting:

- First and most importantly, these two functions are performed to achieve differentgoals. Financial accounting is made to satisfy external stakeholders including investors, creditors, governmental institutions, etc, while management accounting are made to satisfy internal management.
- Second, because financial accounting is performed to satisfy external stakeholders, there are standards to comply with. Generally, these standards are rigid and binding in nature. Objectivity is a virtue. Deviations from the generally accepted standards are punishable by the proper authority. Management accounting on the other hand, are performed in the best interest of internal management. This means fewer standards and less demanding rules. Subjectivities are allowed. Information can be provided in any way as long as it is in the best interest of helping leaders of the company to make the best decision possible.
- Third, financial accounting is backward looking. In other words, it provides information of how the company performs in the past, without estimation of how it will perform in the future. Management accounting

on the other hand, are forward looking. In other words, it focuses on generating a better future for the company. Information gained from the past are used to generate useful estimations of the future.

- Fourth, financial accounting is inward looking in nature. It only cares about financial condition of the company regardless of external economic situations. Management accounting on the other hand, has the obligation to calculate how external conditions will influence corporate financial conditions. It is by far, broader and more open to external factors and considerations.

II. 3. Recognizing the Development of Management Accounting

Using simple deduction, we can expect from the elaboration above that management accounting will experience more changes and much more rapid development rate compare to financial accounting. This is derived from the reality that management accounting is much more ‘ liquid’ and subjective in nature.

Nevertheless, professors in universities and practitioners in the field never expected such a development like what happens in the real business world today. There are times where advanced educational institutions are receiving enormous pressure to update their curriculum to match the existing practice of management accounting (Chenhall, 1997, Ashton, 1995).

For a general example of how management accounting has grown, we can describe the basic differences between ‘ traditional’ management accounting and ‘ modern’ management accounting practices. Traditional management accounting was dominated by the principle technique of ‘ variance analyses.

In short, this is a systematic approach to compare actual and budgeted costs of materials and labor used in a production facility. This function alone has the capability to fulfill some of the purposes of management accounting mentioned above, which is to control present performance, evaluate past performance and make decisions for future performance (Chen, 1995).

Nevertheless, these functions have developed rapidly and embrace concepts like *life cycle costs* and *activity-based costing* . In the perspective of the life cycle costs, managers are suggested to be active in influencing costs at a particular time rather than other because it has been identified that managerial ability to influence costs of manufacturing a product is the greatest when a product is still at its design stage. Small cost reduction at the time will generate significant savings for the entire production activity.

Activity based costing is on the other hand, a more detailed way to identify and manage costs. Within the concept, costs are not defined simply based on the amount of materials and labors that are incurred within the production process, but by identifying existing; ‘ activities’ within the production process and assigning costs upon them (Gosselin, 1997).

Both of these newer concepts are fractions of the development experienced by the management accounting science. A clearer description of how the concept has evolve through the decades are provided in the next chapter

- Evolution of Management Accounting

As described above, the development of management accounting is due to the use of additional techniques that changes the concept from simple into

sophisticated. The adoption of new and innovative techniques is possible due to the subjective and liquid nature of management accounting concepts.

Nevertheless, the core purpose of facilitating decision making for planning, control, evaluation and communication within organizations remain. The following will describe how management accounting developed since the 20 th century.

III. 1. Stage I – Before 1950

Management accounting in this stage was considered in its original form, where technical activities that were required to keep track of business were the only components of management accounting. Management accounting was simply activities of determining product costs. This was quite easy due to the fact that productiontechnologywas relatively simple at the time. After defining the labor and material costs, managers can determine overhead simply by relying on direct labor hours.

At this stage, there were less competition and fewer challenges in the form of regulation, etc. Products were easier to sell and little innovation was required. Hence, people focused on cost effectiveness and productivity. The use of budgets and basic cost accounting were already popular and important, but the distribution of information for managerial decision making was still at a poor stage. Managers are still eager and vary much allowed to make decision based on intuition and personal experiences.

III. 2. Stage II 1950-1965

In the second stage of management accounting development, the concept developed to involve more than just technical costing activities. By this time, it has included planning and controlling activities. Experts believed that by this time, management accounting has shifted into a managerial rather than technical work, but it remains on the staff level. In other words, management controls were limited in manufacturing and administration rather than thinking about strategic directions. Therefore, management accounting remained reactive. Actions are taken only when problems are discovered through deviation analysis.

III. 3. Stage III 1965-1985

The third stage was noted to represent a significant change in the practice of management accounting. Corporate leaders and managers are joined in common interest to reduce waste in corporate processes by making the most effective and efficient decision. This significantly enhances the need for a better management accounting techniques and practices.

The management accounting department can no longer afford to become reactive and passive. Aggressive cost reduction plan and efficiency management performed by many companies drives management accountant to be sharper and more creative in providing information that will support managers in decision making.

Researchers believed that such a change occurred because of the oil crisis of 1970. This pulled the world into a recession and even threatened the already established and stable western markets. Competition enhanced and the need to have a better financial management strategy rose. Others however,

believed that it was the rapid development of new production technologies that increases competition and generated new opportunities to enhance management accounting practices. With the new computer technologies, there was a new challenge to meet the global competition by better managing information for decision making

III. 4. Stage IV 1985-1995

In this stage, the development of management accounting was boosted mainly by the presence of new computer and communication technology like the World Wide Web and E-Commerce. Competition enhanced, however the name of the game is no longer reducing waste or resource efficiency management, but rather to generate value through effective use of available resources. Since then, management accounting professionals have been struggling to increase value generation by providing better information for management teams who were already having a clearer strategic focus.

1. Recent Issues in Management Accounting Evolution

Despite the rapid development of management accounting process we have witnessed in the 20 th century, we have also seen that in this first decade of the 21 st century there is quite a downturn. Companies starting to complain because their management accounting department produces information that are lack accuracy, timeliness and relevance. Several writers and observers have stated that the management accounting discipline of the 21 st century requires quite a change to fulfill the increasing need of managers for reliable and timely information.

These writers have not yet come up with a practical solution to jumpstart the quality of management accounting practices in the 21 st century, but they have elaborated some of the reasons of such a downturn. The most important factor that generates the decreasing performance of management accounting is actually the increasing importance of financial accounting. Stakeholders are more scrutiny in ensuring that their companies are complying with every rules of financial accounting, which are agreed by a trusted external accounting committee (Drury, 1995).

The result of this development is the increasing attention of managers and corporate leaders over the practice of financial accounting rather than management accounting. In theory, both of these functions can supposedly be performed together in the same time, but recent reports indicated that in some companies, due to the increasing demands over complying with the rules of financial accounting, management accounting practices are left behind quite significantly.

In some companies, management are left with no time but to ensure that financial accounting practices are performed completely, that they are forced to make decisions based on the information provided by the financial accounting process. Ironically, due to the differences of information characteristics between financial accounting and management accounting, this means that management are not making decisions based on forward-looking and broadly-processed information, but instead, a backward looking and inwardly-processed information.

References

Ashton, D., Hopper, T. and Scapens, R. 1995. ‘ The changing nature of issues in management accounting’, in ‘ Issues in Management Accounting’, Ashton, D., Hopper, T. and Scapens, R. (editors), Prentice Hall, Hertfordshire

Béguelin, Jean-Pierre. (2002). Old Bridges and New Coins Euro: a New Currency. *Journal of Financial Planning*

Chenhall, R. 1997. ‘ Reliance on manufacturing performance measures, total quality management and organizational performance’. Management Accounting Research, vol. 8, pp. 187-206.

Chen, S. 1995. ‘ An empirical examination of capital budgeting techniques: impact of investment types and firm characteristics’. The Engineering Economist, Vol. 40, No. 2, Winter, pp. 145-170.

Chong, V. 1996. ‘ Management accounting systems, task uncertainty and managerial performance: a research note’. Accounting, Organization and Society, Vol. 21, No. 5, pp. 415-421.

Clark, Emma. (2001). *The Euro Hits Home in the UK* . Retrieved November 15, 2007 from http://news. bbc. co. uk/1/hi/events/the_launch_of_emu/the_uk_and_emu/search

Drury, C. and Tayles, M. 1995. ‘ Issues arising from surveys of management accounting practice’. Management Accounting Research, Vol. 6, pp. 267-280.

Gosselin, M. 1997. ‘ The effect of strategy and organizational structure on the adoption and implementation of activity-based costing’. Accounting, Organization and Society, Vol. 22, No. 2, pp. 105-122.