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An Introduction to Management Accounting

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Abstract:
This paper will introduce It 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. It 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. It will see that, in a number of ways, management accounting is quite different from other forms of accounting.

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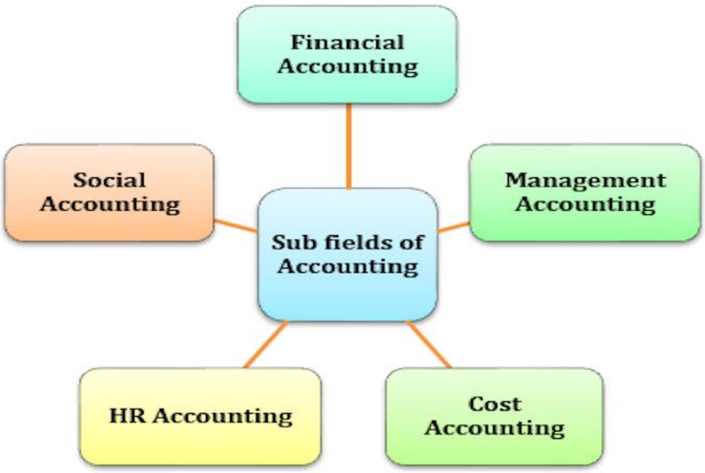
I. Introduction

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.



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.

II . 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 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 instanc e, the explosion in financial instruments, have helped to expand the world of financial accounting. Additionally, attempts to harmonies the various systems of accounting standards across the world, 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.
• 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.

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 highlevel 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 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.

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 authors see management accounting as a symptom of perceived ills in society – as a tool of the operation of subversive forces.

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.

III. Conclusion

This paper 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.

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