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Management Accounting Concepts

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INTRODUCTION

1. This statement describes that field of organizational activity known as management accounting. It is an activity that is interwoven in the management processes of all organizations. The purposes, tasks and parameters of management accounting are described, and are elaborated in terms of a conceptual framework.

2. The statement recognizes that

   - different labels, in different languages, are used to refer to management accounting around the world;
   - this field of activity is approached and organized differently in different countries, cultures and organizations; and
   - the body of thought and practice encompassed by management accounting has changed and evolved, and will continue to do so.

3. The statement has two main elements.

   - First, management accounting is described by reference to leading edge practice internationally.
   - Second, a conceptual framework elaborates the description and serves both as a set of assumptions for reasoning about appropriate directions for practice, and as a set of criteria for evaluating good practice.

4. Together the description and conceptual framework provide a benchmark of best practice in management accounting, and can serve as a resource in developing practice in this direction.

5. The statement can be used to answer the following critical questions:

   - How should management accounting practice be developed?
   - How should the usefulness of management accounting practice be tested?
   - How should management accounting work technologies be developed?
   - How should the usefulness of management accounting work technologies be tested?

6. By describing the motivation and fundamental qualities involved in modern management accounting, the statement should contribute both to understanding and improving practice worldwide.

EVOLUTION AND CHANGE IN MANAGEMENT ACCOUNTING

7. The field of organizational activity encompassed by *management accounting* has developed through four recognizable stages.

   - **Stage 1 —** Prior to 1950, the focus was on cost determination and financial control, through the use of budgeting and cost accounting technologies;

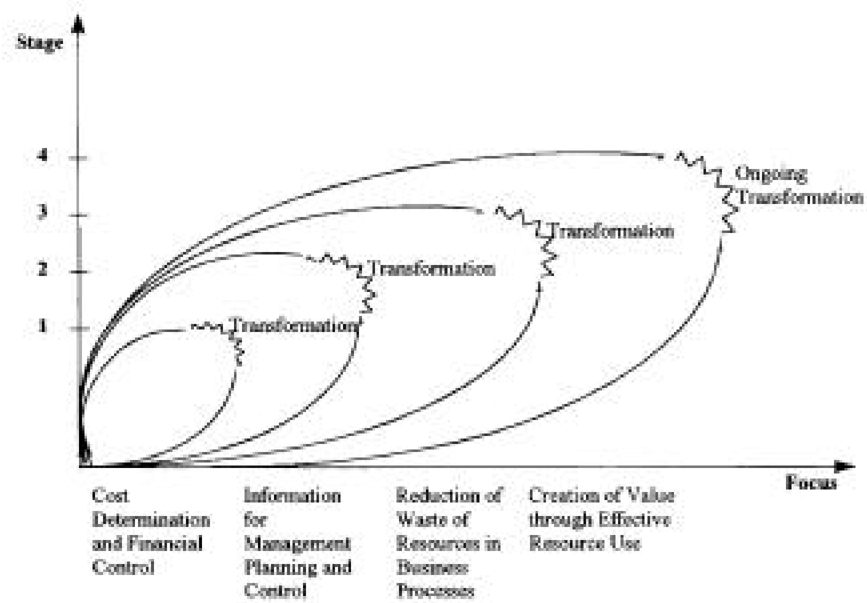
- **Stage 2 —** By 1965, the focus had shifted to the provision of information for management planning and control, through the use of such technologies as decision analysis and responsibility accounting;
- **Stage 3 —** By 1985, attention was focused on the reduction of waste in resources used in business processes, through the use of process analysis and cost management technologies;
- **Stage 4 —** By 1995, attention had shifted to the generation or creation of value through the effective use of resources, through the use of technologies which examine the drivers of customer value, shareholder value, and organizational innovation.

8. While these four stages are recognizable, the process of change from one to another has been evolutionary.

9. Each stage of evolution represents adaptation to a new set of conditions facing organizations, by the absorption, reshaping, and addition to the focus and technologies used previously. Each stage is a combination of the old and the new, with the old reshaped to fit with the new in addressing a new set of conditions in the management environment.

10. The following diagram illustrates the four evolutionary stages of management accounting:

Evolution of Management Accounting



11. There is little doubt that management accounting will continue to evolve in the future.

12. In this context, the use of the label *management accounting* is problematic, for three reasons.

    - In many countries around the world the label has never been used to refer to the organizational activities in focus in any of the stages; instead unique language and culture specific labels have been used.
    - In some countries, the label has been used to refer to one or more of the four stages.
    - In other countries (English speaking mainly) the label has been used to encompass the processes in focus in all four stages.

13. Thus, for many the label may be meaningless, and for others the meaning may be unclear.

14. The label *management accounting* is used in this statement with an appreciation of these difficulties, and with an acknowledgement that it may be replaced by other labels in the future.

15. *Management accounting* here refers to the outcome of the process of evolution over the four stages.

16. While this statement of Management Accounting Concepts describes management accounting as it has evolved at Stage 4, the statement which it replaces described management accounting as it had evolved at the juncture of Stages 2 and 3 — when the focus was on the provision of information for management planning and control. For illustrative purposes, extracts from the previous Statement of Management Accounting Concepts are attached as an Appendix.

17. A critical difference in the shift between Stage 2 and Stages 3 and 4 is the change in focus *away from information provision* and *towards resource management*, in the forms of waste reduction (Stage 3) and value generation or creation (Stage 4). The focus on information provision (Stage 2) is not lost, but is refigured in Stages 3 and 4. In Stages 3 and 4, information is seen as an organizational resource, along with other organizational resources; the focus now, however, is on reducing the loss or waste of this resource (in both financial and real terms) and on conserving or leveraging its use in value generation or creation.

18. Like other resources, information (alone or in combination with other resources) may have present strategic significance or may be a core competency used to create new organizational futures. In any case, it is brought within the ambit of organizational activities designed to manage resources strategically (management accounting at its current evolutionary stage).

19. A second critical difference is the way in which management accounting as a field of activity is positioned within organizations.

    - In Stage 1, it was seen as a *technical* activity necessary for the pursuit of organizational objectives.

- By Stage 2, it seen as a *management* activity, but in a *staff* role; it involved *staff* (management) support to *line* management through the provision of information for planning and control purposes.

- In Stages 3 and 4, it is seen as an *integral part of the management process*, as *real time* information becomes available to management directly and as the distinction between *staff* and *line* management becomes progressively blurred. *The focusing of the use of resources (including information) to create value is an integral part of the management process in organizations*.

20. Management accounting (at its current evolutionary stage) addresses the needs of organizations operating in dynamic and competitive *contexts*. In these contexts, organizations currently are

    - flattening their hierarchical structures, whilst progressively empowering front-line employees — in order to increase their agility as well as employee commitment;
    - removing functional specialization (through the use of cross-functional teams, as well as the elimination of traditional specializations), to more clearly focus on the business processes which support strategic product/service portfolios;
    - removing divisions between themselves and suppliers and customers (for example, by alliances or partnerships), in order to more firmly locate their business processes in relevant value chains;
    - undertaking experiments in seeking to understand their *core competences* and their identity within relevant value chains, by progressively becoming more *virtual* as they respond to rapidly shifting product/service life cycles in the face of global competition;
    - simultaneously integrating their information systems and highlighting the availability of localized information in *real time* at points of need;
    - removing reliance on *remote* forms of financial control, by creating real time localized control based on non-financial Performance Indicators;
    - treating ambiguity and paradox as realities to work with and through, rather than as impediments to be removed by continuing investments in information and rationality; and
    - pursuing cultural integration through a focus on understood and accepted visions, rather than accepting the forms of cultural separation associated with traditional forms of employment or professional specialization.

MANAGEMENT ACCOUNTING AND THE MANAGEMENT PROCESS

21. The purpose of management has been described as making people capable of joint performance through common goals, common values, the right structure, and providing the training and development they need to perform and to respond to change. The central purpose, then, of the management process is to secure, as it faces change, the vitality and endurance of an

organization through the ongoing co-ordination of activities, efforts and resources. Thus, the management process includes

- establishing organizational directions in terms of objectives and strategies;
- aligning organizational structures, processes and systems to support established directions;
- securing the commitment at a requisite level of those contributing essential skills and effort; and
- instituting controls that will guide an organization's progress towards the realization of its strategies and objectives.

22. The level of contextual change faced by organizations, however, requires that management is involved in an ongoing *redirection* of objectives and strategies, and thus in ongoing *change* of structures, patterns of commitment, and controls.

23. The pursuit and realization of organizational objectives and strategies requires the mobilization or development of requisite capabilities through the effective deployment of resources. Resources are deployed in structures, controls, and securing commitments to create the capabilities necessary for organizational success. Without effective resource deployments, requisite capabilities are unlikely to be developed; and resources are likely to be wasted in ineffective structures, controls, and commitments. Moreover, as requisite organizational capabilities are redefined through ongoing organizational redirection, it is likely that resource deployments will need to alter. Resourcing thus is an integral part of the management process.

24. The management of resourcing and resource use is integral to both strategy realization and organizational change; effective resource deployments are necessary to support organizational objectives and strategies, and ongoing organizational change is likely to require ongoing redeployments of resources. Indeed the success of management in securing the vitality and endurance of an organization is likely to be dependent on the effectiveness with which it deploys and redeploys resources.

25. The management process may be partitioned in various ways. In this statement it is divided into component parts that focus respectively on

- organizational direction setting;
- organizational structuring;
- organizational resource use;
- organizational commitment;
- organizational change; and
- organizational control.

26. While these components of the management process are isolated analytically, it is emphasized that they are intertwined in practice. Thus, each component part will be in interaction with the others, as organizational survival or success is pursued.

27. Distinctive *technologies* — modes of thought and practice used in the processes involved in a field of activity, are associated with each part of the management process.

28. In this statement management accounting refers to that part of the management process which is focused on organizational resource use. Thus, it refers to managerial processes and technologies that are focused on adding value to organizations by attaining the effective use of resources, in dynamic and competitive contexts.

29. Management accounting, as an integral part of the management process, distinctly adds value by continuously probing whether resources are used effectively by organizations — in creating value for shareholders, customers or other stakeholders.

30. Distinctive modes of thought and practice, referred to as *technologies*, are used in management accounting.

31. In this regard, *resources* include not only those in financial form, but also all other resources created and used by organizations as a result of financial expenditures. Thus, work processes and systems, trained personnel, innovative capacities, morale, flexible cultures, and even committed customers may be included as *resources* — along with special configurations of resources that may be identified as strategic capabilities, core competences or intellectual capital.

32. Management accounting refers to that part of the management process focused on the effective use of resources in

    - establishing *strategy* mixes that support organizational objectives;
    - developing and maintaining the organizational *capabilities* necessary for strategy realization; and
    - negotiating the strategy and capability *change* necessary to secure ongoing organizational success and survival.

33. Information and knowledge are likely to be resources that are central to an organization's success and survival in an increasingly competitive and fast changing world. Thus, emphasis is likely to be given within the management accounting process to the effective use of these resources in supporting strategic positioning and developing the capabilities necessary for organizational success and survival.

34. Management accounting is only one part of the management process of organizations. It provides a focus and distinctive perspective on one key dimension of organizational activity — resourcing and resource use. It stands beside other parts of the management process which focus respectively on other key dimensions of organizational activity — direction setting, structuring securing commitment, control, and change. However, it is interwoven with other parts of the management process, by being associated with

    - organizational direction setting, *from a resource perspective*, through involvement in

- objective setting;
- strategy formulation and implementation;
- project appraisal and implementation;
- business planning;
- resource deployment;
- decision support.

• organizational structuring, *from a resource perspective*, through involvement in

- designing organizational and business processes to support strategies;
- designing systems to support processes;
- aligning capabilities with processes and systems;
- decision making about the outsourcing or insourcing of processes, capabilities and systems;
- assigning responsibilities for processes, systems and capabilities;
- deploying resources to processes, systems and capabilities.

• organizational commitment, *from a resource perspective*, through involvement in

- establishing the vision of an organization, and its core values;
- establishing the organization's core capabilities and competences;
- building understanding of key organizational success factors and capabilities;
- building motivation and trust across all organizational participants;
- establishing and implementing mechanisms for the sharing of gains and success;
- providing feedback on individual, team and organizational development.

• organizational change, *from a resource perspective*, through involvement in

- focusing change on strategy realization;
- establishing change targets and goals;
- embedding change in organizational and business processes;
- re-engineering or continuous improvement initiatives;
- providing information or feedback related to change initiatives;
- monitoring the outcomes of change initiatives.

• organizational control, *from a resource perspective*, through involvement in

- profiling the risk exposures associated with organizational strategies and business processes;
- establishing and managing control parameters related to risk exposures;

- establishing Performance Criteria and Measures related to an organizations strategic success, and financial and operational processes;
- designing and operating information systems supporting an organization's operations, performance measures, controls and accountabilities;
- instituting accountabilities related to risk management, and operational and strategic performance.

35. While the term *function* can be used to refer to characteristic and distinctive parts of an organization (e.g., departments, divisions) or to the assignment of activities or responsibilities to individuals, it is *not* used in this way in this statement. It is used here to refer to characteristic and distinctive parts of the *management process.* Thus, that part of the management process concerned with effective resource use over time can be referred to as the *management accounting function*.

36. Distinctive management functions, however, also need to be brought under management oversight and direction, to ensure that they add value to an organization through their distinctive focus and purpose. Management accounting is no exception.

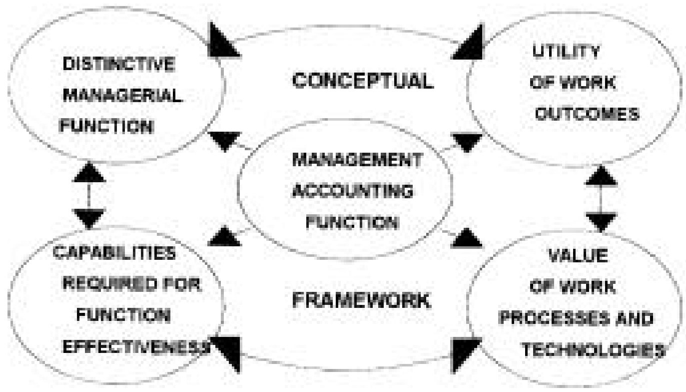
    - The management of the management accounting function is likely to involve
        - establishing objectives and strategies for the function;
        - structuring the work of the function;
        - building the capability of the function;
        - resourcing the function appropriately;
        - responding creatively to, or proactively addressing new challenges bearing on the work of the function;
        - assessing the ongoing efficiency and effectiveness of the function.

THE CONCEPTUAL FRAMEWORK

37. The description of management accounting developed in this statement can be elaborated through a set of concepts categorized in terms of

    - the distinctive *function* of management accounting within the management process in organizations;
    - the way in which the *utility* of the outcomes of the management accounting process can be tested;
    - *criteria* which can be used to assess the value of the processes and work technologies used in management accounting; and
    - *capabilities* necessarily associated with the effectiveness of the management accounting function overall.

38. Each category of concepts articulates with the others as a conceptual framework for management accounting. The conceptual framework can be illustrated as follows:



39. The conceptual framework can be used to describe *best practice* in management accounting because it focuses attention on

- the capabilities required for effective performance of the distinctive work of the function;
- assessments of the organizational value of the work outcomes of the function; and
- the usefulness of the function's work processes and technologies in securing such outcomes.

40. Within each category of the conceptual framework, the following specific concepts can be developed in further elaboration.

Function Related Concepts

41. These concepts describe the function in terms of its resource productivity focus, value orientation, business process orientation and team orientation.

Resource Productivity Focus

42. The management accounting process is focused on the efficient and effective use of resources in organizations. Attention is focused on the transformation of resources in and out of financial forms, and on attendant patterns of waste (resource loss) and value generation (effective use of resources). Resources in monetary and physical forms are scrutinized, along with resources consumed by organizational structures, systems, procedures, processes and human resources practices.

Value Orientation

43. The effectiveness of resource use is judged in terms of the value generated in both product/service markets (for customers) and capital markets (for shareholders), while satisfying the requirements of other key organizational stakeholders (including suppliers, staff, financiers, and the community at large).

44. Resource use is judged effective if it optimizes value generation over the long run, with due regard to the externalities associated with an organization's activities.

45. Waste (resource loss, idle resources), unfocused use or consumption of resources, and inattention to environmental or social concerns are likely to be judged ineffective.

Business Process Orientation

46. Management accounting work is centered on the core and enabling business processes of an organization, involving customers, suppliers and other stakeholders. Thus, it is concerned with

    - inter-relationships between organizational processes and inter-organizational value chains;
    - interfaces between organizational processes and work technologies, structures, systems and cultures;
    - the alignment between organizational processes and product/service strategies; and
    - the way in which resources are deployed, used and consumed by organizational processes in generating value over time.

Team Orientation

47. The management accounting process is deployed within, and conducted through the various types of teams established to undertake the work of organizations.

48. Teams may have a strategic, managerial or operational focus; they may have a task, activity, process or cross-functional orientation; and they may be given various forms of empowerment and developmental expectation.

Outcome Utility Related Concepts

49. These concepts address the utility of the work outcomes of the management accounting function, and how it might be assessed in terms of accountability, performance criteria, and benchmarked performance.

Accountability

50. The outcomes of the management accounting process are assessed in terms of the value they add to an organization, judged from the perspective of users of the outcomes. Thus, the accountability of the management accounting

function is outwardly directed, to organizational participants served by the function.

Performance Criteria

51. The value to be added by management accounting work to an organization can be expressed in terms of staged performance objectives, negotiated and agreed to within an organization.

Benchmarking Performance

52. The performance objectives used to express management accounting accountabilities within an organization should reflect the outcomes of benchmarking management accounting work across organizations.

Process and Technology Related Concepts

53. Management accounting processes interface with other management processes and are informed by a distinctive mode of thinking, which can be used also to assess or guide the development of the work technologies used in management accounting.

Equation of Resource Use and Value Generation

54. The management accounting process draws on a distinctive mode of thinking, focused on the equation of resource use and value generation over time.

55. Ideally, resource use is measured by opportunity cost, or approximations thereto.

56. Value generation is measured from the perspectives of customers or shareholders, and their respective utility functions - after due consideration of the interests of other stakeholders and any external impacts on society generally as a result of an organization's operations.

57. Exploration of relationships over time involves an active consideration of interactions between short-run and long-run effects.

Management Process Interfaces

58. Management accounting adds a resource perspective to other management processes concerned with organizational direction-setting, structuring, change and control. These points of interface are themselves likely to require management, to ensure that organizational value is created as a result.

Technology Development and Evaluation

59. The work technologies used in the management accounting process also can be evaluated in terms of the equation between resource use and value generation.

60. The value generated by a work technology used in the management accounting process should more than compensate for the resources it uses or

consumes.

61. Deficiencies in existing work technologies assessed relative to this criterion, should prompt the development of new or revised work technologies. In turn, such development can be guided by the equation between value generation and resource use.

Function Capability Related Concepts

62. The capabilities required for effective performance by the management accounting function within the management process of organizations are centered on the core competences seen as necessary, on a culture that embodies continuous improvement and opportunity creation, and on a capacity for critical self-consciousness about the function’s effectiveness.

Core Competences

63. The work of the management accounting function should be organized around, and pursued though an identified set of core competences which reflect best practice and which are sufficient to secure effective outcomes.

64. These core competences may consist of the expertise of staff involved, the interactive work processes used, the types of systems support available, the technologies utilized in work processes, the legitimacy and respect accorded to the work of the function, the quality of management of the function, and other relevant factors.

65. The identification of a requisite set of core competences will be guided by an understanding of what needs to be achieved by the function in terms of outcome effectiveness, and by the core competences possessed by representative ‘best practice’ management accounting functions.

Continuous Improvement

66. A management accounting function should embody a culture of continuous improvement. This culture will be represented at any time by a range of initiatives designed to improve the work of the function, through the enhancement of its competences and the ways in which these are mobilized and used.

Creating Opportunities

67. A management accounting function should embody a culture of proactivity, in seeking out and finding opportunities for value creation within organizations.

68. This culture will be represented by creative responses to externally generated challenges, by the anticipation and identification of needs, by a readiness to capitalize on possible or emerging opportunities, and by the creation of opportunities for value generation, which might not be realized otherwise.

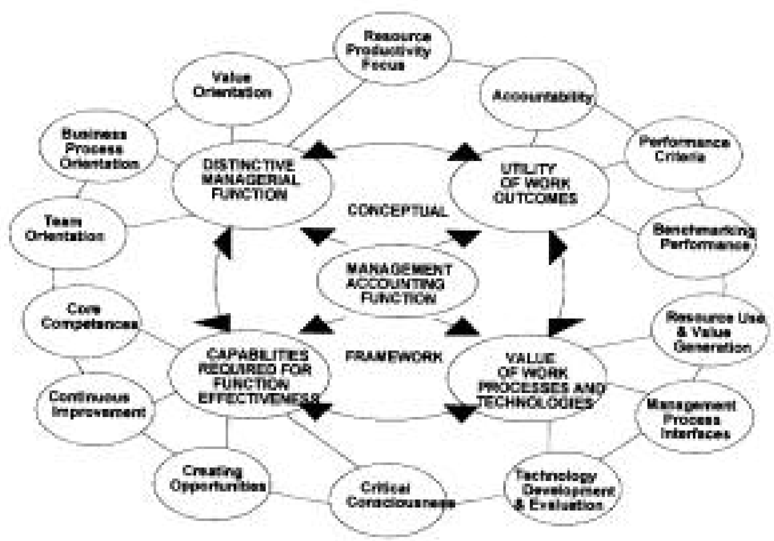
69. This cultural attribute should be seen as a core competence of the function.

Critical Consciousness

70. The work of the management accounting function, including improvements to it, should be subjected to a continuous evaluation in terms of efficiency and effectiveness.

71. Both the work processes and the outcomes of the work of the function should receive a critical assessment in terms of the value they generate relative to the resources used, over time.

72. The specific concepts described form part of the conceptual framework of management accounting, as illustrated on the following page.



USING THE CONCEPTUAL FRAMEWORK

73. The conceptual framework elaborates the description of management accounting, by reference to best practice internationally. Thus, it can serve also as a guide for the evaluation or development of management accounting practice in particular organizational applications. Consider how the answers to the following questions can be derived directly from the conceptual framework.

74. How should management accounting practice be developed?

- So that it focuses on the effective use of organizational resources (Resource Productivity Focus), where effectiveness is judged in terms of the value generated for key organizational stakeholders (Value Orientation).

- So that it is centered on the key business processes of the organization (Business Process Orientation).

- So that it is integrated with the work of other specialist functions, as part of the management team of the organization (Team Orientation).

- So that it draws from a commonly understood set of core competences relating to the work of the function (Core Competences).
- So that it is driven by continuous improvement initiatives related to the work of the function (Continuous Improvement).
- So that it proactively seeks opportunities for value creation within organizations (Creating Opportunities).
- So that it is continuously reviewed in terms of the value it generates relative to the resources it consumes (Critical Consciousness).

75. How should the usefulness of management accounting practice be tested?

    - In terms of its embodiment of a culture of proactivity in finding opportunities for value creation within organizations (Creating Opportunities).
    - In terms of the value it adds to the organization, from the perspectives of other organizational participants (Accountability).
    - Where such accountability is expressed in terms of staged performance objectives, negotiated and agreed to within the organization (Performance Criteria).
    - Where the performance objectives are reflective of externally referenced competent practice (Core Competences), and performance outcomes are benchmarked across organizations (Benchmarking Performance).

76. How should the usefulness of management accounting work technologies be tested?

    - In terms of the value they create in adding a resource perspective to other management processes (Management Process Interfaces).
    - Through an ongoing critical assessment in terms of efficiency and effectiveness (Critical Consciousness).
    - Which is focused on the resources they consume relative to the value they generate over time, in the full range of organizational involvements of the management accounting process (Technology Development and Evaluation).

77. How should management accounting work technologies be developed?

    - By constant reference to the distinctive mode of thinking used in management accounting work, centered on an equation of resource use and value generation over time (Equation of Resource Use and Value Generation).
    - By reference to the value added by a resource perspective to other management processes (Management Process Interfaces).
    - Through processes of continuous improvement built into the culture of the management accounting function (Continuous Improvement).
    - And by reference to the set of core competences deemed necessary for the effective performance of management accounting work (Core

Competences).

CONCLUSION

78. This statement is designed to be used and useful; it is to be judged by its practical value in various domains. It can be used by

- *managers* in organizations for understanding, evaluating and developing that distinctive area of their work concerned with the effective use of resources;
- *professional accountants in management* in focusing, benchmarking and developing their contributions to management accounting processes in organizations;
- *educators* in refocusing and consolidating their efforts on a rapidly evolving area of practice, where capacities to both understand and contribute to change are important outcomes of learning processes;
- *professional associations and others* in reformulating and consolidating the work technologies to be associated with management accounting now and in the future.

79. It can be used also as an international point of reference for understanding different institutional and cultural approaches taken to management accounting work around the world.

Appendix

The statement of Management Accounting Concepts issued in February 1989, clearly identified management accounting as an integral part of the management process, which provided *information* for management planning and control. Accordingly, its framework of concepts focused on *the qualities that should be possessed by such information*, “as the foundation on which management accounting practices and techniques are developed and their usefulness tested”.

The following *extracts* are illustrative.

****

Management Accounting

3. Management accounting may be defined as the process of identification, measurement, accumulation, analysis, preparation, interpretation, and communication of information (both financial and operating) used by management to plan, evaluate, and control within an organization and to assure use of and accountability for its resources.

4. Management accounting, therefore, is an integral part of the management process. It provides information essential for

   - controlling the current activities of an organization;
   - planning its future strategies, tactics and operations;
   - optimizing the use of its resources;
   - measuring and evaluating performance;
   - reducing subjectivity in the decision making process; and
   - improving internal and external communication.

The Concepts

Accountability

7. Management accounting presents information measuring the achievement of the objectives of an organization and appraising the conduct of its internal affairs in that process. In order that further action can be taken, based on this information, it is necessary at all times to identify the responsibilities and key result areas of the individuals within the organization.

Controllability

8. Management accounting identifies the elements of activities which management can or cannot influence, and seeks to assess risk and sensitivity factors. This facilitates the proper monitoring, analysis, comparison and interpretation of information which can be used constructively in the control, evaluation and corrective functions of management.

Reliability

9. Management accounting information must be of such quality that confidence can be placed in it. Its reliability to the user is dependent on its source, integrity and comprehensiveness.

Interdependency

10. Management accounting, in recognition of the increasing complexity of business, must access both external and internal information sources from interactive functions such as marketing, production, personnel, procurement, finance, etc. This assists in ensuring that the information is adequately balanced.

Relevancy

11. Management accounting must ensure that flexibility is maintained in assembling and interpreting information. This facilitates the exploration and presentation, in a clear, understandable and timely manner, of as many alternatives as are necessary for impartial and confident decisions to be taken. The process is essentially forward looking and dynamic. Therefore, the information must satisfy the criteria of being applicable and appropriate.