

## Management Accounting and its Role in Organizations

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**Abstract:** In this study, the role and importance of management accounting in organizations in achieving the organizational goals has been discussed. Management accounting in the world has enjoyed a rapid growth and dynamics and has regularly presented new intellectual products to the managers and leaders of the organizations. In addition, management accounting, as new business knowledge, can help the managers in successful interactions with one another with a variable environment through providing information. Managers in both profit and nonprofit organizations have an interaction with their own management accounting system. Sometimes, a manager uses the management accounting system for planning and decision making and in some other times, this system measures the performance and affects the managers' behavior. Management accounting system is considered as a source of information for making planning decisions and at the same time it is considered as a part of control system of an organization. Management accounting helps to create value in an organization through improving decision making process and control of organizational members.

[Issa Heidari. **Management Accounting and its Role in Organizations** *Life Sci J* 2012;9(4):545-550] (ISSN:1097-8135). <http://www.lifesciencesite.com>. 82

**Key words:** management accounting, cost management, Development, Organization

### 1. Introduction

Nowadays, the organizations are faced with severe complexities and changes due to the technological development in the industries and changes in production systems. These changes are to the extent that the management alone could not fully understand its environment in the organization. Therefore, it has become necessary to provide a system to help the management in specifying the problems, setting goals, precisely identifying the issue, defining possible solutions, evaluating solutions, and selecting, implementing, monitoring and evaluating the optimum solution. Management information system and decision support systems have been created and developed for this purpose. Management accounting information system has been also developed in the same field, so that it provides an important part of the information required by management. For these reasons, the manager cannot perform its duties efficiently, even by relying on personal information and experiences and the information reflected in the financial statements. Management accounting information system has been emerged, grown and developed with development and complication of the production system in order to help the management in decision making. The role of management accounting "is to prepare and provide relevant and useful information to help management in planning the activities, applying management control and rational decision making in achieving the organization's goals". Management accounting should not be considered as a set of fixed rules, because it tries to help the intra-organizational

individuals in making decisions and is a reliable guide in determining future policies and planning of the organization.

### 2. What is Management accounting?

Management accounting is a system of measuring and providing operational and financial information that guides managerial action, motivates behaviors, and supports and creates the cultural values necessary to achieve an organization's strategic objectives. There are four key ideas contained in this definition of management accounting. These ideas capture the nature, scope, purpose, and attributes of management accounting.

1. By nature management accounting is a measurement process.
2. The scope of management accounting includes financial information, such as cost, and operational information, such as percentage of defective units produced.
3. The purpose of management accounting is to help an organization reach its key strategic objectives. It is not meant for mandated financial and tax reporting purposes.
4. Good management accounting information has three attributes:
  - Technical—it enhances the understanding of the phenomena measured and provides relevant information for strategic decisions.
  - Behavioral—it encourages actions that are consistent with an organization's strategic objectives.
  - Cultural—it supports and/or creates a set of shared cultural values, beliefs, and mindsets in an organization and society.

### 3. Definitions of management accounting:

Managerial accounting is concerned with providing information to managers- that is, to those who are inside an organization and who direct and control its operations. Managerial accounting can be contrasted with financial accounting, which is concerned with providing information to stockholders, creditors and others who are outside an organization [4]

International Federation of Accountants (IFAC), has defined management accounting as follows: "Management accounting is the process of recognition, measurement, accumulation, analysis, planning, interpretation and relation of (financial and operational) information which is used by the managers to plan, evaluate and control the organization and to ensure accounting and how to use the respective sources".

Institute of Management Accountants (IMA) defines management accounting as follows: "Management accounting is the process of identification, measurement, collection, analysis, preparation, interpretation, evaluation and internal control of the organization's activities to ensure the appropriate use of capital."

According to the definition of Chartered Institute of Management Accountants (CIMA), The world's largest international source of management accounting, management accounting is defined as follows:

Management accounting is to apply the principles of accounting and financial management in order to create, preserve, store and increase value from the view point of public or private profit or nonprofit organizations [10]. Management accounting is the part of management which identifies, produces, provides and interprets the information associated with the following objectives[14]:

- Helping to make strategic decisions and design organizational strategies
- Long-term, medium-term and short-term planning of activities
- Determining the capital structure and financing this structure
- Designing motivational strategies for senior managers and stakeholders
- Contribution to making the operational decisions
- Control of operations and ensure of efficient use of resources
- Measuring and reporting financial and non-financial performance to the managers and the other stakeholders
- Safeguarding tangible and intangible assets

- Implementing processes of administration of organization, risk management and internal controls

### 4. The importance of management accounting

Management accounting is one of the most important management tools in designing the required guidelines and planning to achieve the organizational goals. According to the type of activity, the organizations have different goals but at the same time they have also common goals in some cases, such as resource management and cost reduction of activities and services [12]. In today's world, technological changes and changes of customer tastes and the international market competition have made the organizations the dynamic units whose prerequisite for survival and excellence in this field have been made by them. Inevitably, these organizations choose systems through which they can provide their required information along with these changes. Since the management accounting does not follow a closed framework and accepted rules and principles, it has the required flexibility. Management accounting is responsible for providing the information required by managers in decision-making process, planning, leadership and control of normal activities as well as the possibility of measurement and evaluation of performance of sub-units, managers and other employees and ultimately helps in achieving the organizational goals, including profitability, cost price reduction, product diversification, risk mitigation, preeminence in the competition market, product quality, increase of productivity and efficiency.

Naturally, management accounting is a process and a system used to collect information and measure whose performance is represented as operational and financial information and its purpose, as an effective tool for managers, is to help the organization to achieve its great goals [8]. The role of management accounting can analytically be considered as creation of solutions to get the information in the past and present and future programs, derived from extra-organizational and intra organizational factors which provides appropriate information and make it available to the management using tools as understandable models and interprets this information in a way that it would allow the assessment of the internal units and products and facilitates decision making by providing effective information in contrast to the problems beyond the enterprise and makes it possible to focus on future events through preparing the ground for strategic planning. Accounting management can play a highly valuable role in identifying and revising work procedures to control and review the activities and identifies the deviations

occurred by comparing the predicted goals with actual performance, and analyzing and interpreting them, presents appropriate strategies to the management to improve the structure and activities.

It can be generally noted that management accounting is a system to measure and collect financial and operational information which leads management activities and motivational behaviors and creates and supports the cultural values needed to achieve strategic goals of the organization [2].

### 5. Key processes of management accounting

Key processes of management accounting include the following items:

**Analysis:** Endogenous and exogenous complications from past and present information and future plans are resulted from the internal and external environment of the company [7]. The role of management accounting is to design mechanisms to obtain financial information with a cost effective (cost - benefit) method and then to make the information available to the management at the right time [3].

**Decision making:** management accounting, in fact, plays an important role in providing effective information for the managers' decision making on solving the existing problems [11].

**Planning:** One of the key and major tasks of management accounting is to focus on future events. In many companies, the historical data can be used to evaluate the changes in major operations and a guide for the strategic operations. Management accounting has an important role in providing the ground for planning of providing trivial activities in quantitative goals.

**Control:** Although management accounting normally has no updated control on the operations of the organization, it can play an important role in determining and improving the mechanisms for reviewing and controlling the organization's activity [9]. Comparing goals of planned and actual activities (what has happened), management accounting can detect the differences, investigate further commitments and then, present practical and useful suggestions to the managers.

#### Main topics of management accounting

All aspects of management accounting are practically influenced by several major topics, which include:

**a. Information:** The need for information is usually considered as a driving force to the management accounting [6]. Management accounting information often satisfies two main purposes:

- Facilitating decision making
- Affecting decision making

Decision makers will be provided with information to help them choose the best solution. This information often affects the decision of managers. For example, imagine the annual budget of a profit organization. Although the budget is provided by management accounting, it must be finally approved by senior management of the profit organization. In addition, budget information affects the managers' decision making. Because, at the end of the year, actual expenditure will be compared with budgeted amounts and any significant deviation will be analyzed.

**b. Behavioral effects:** reaction of managers and staff to management accounting information often has important effects on the events of profit units. For example, what is the reaction of production manager to the approved budget? Or how does the information of the cost price goods affect the pricing of goods and services? Or ... All these questions are related to behavioral tendencies of people and their limitations in the related information. The more understanding of the management accountants of the employees' behaviors; the more effective will be the provision of required information for them.

**c. Costs and benefits:** Information can be considered as goods. Information can be obtained or purchased and used as other goods. Information can be of high or low quality, can be presented timely or delayed, and finally can be relevant or irrelevant. Like other goods and services, providing information is costly and is expected to have benefits. Cost of providing accounting information in profit organizations usually includes salaries and benefits of management accounting staff, purchasing and computer operation costs and expenses spent by the data users for studying, and comprehension and using information. Benefits of information also include more effective planning, improvement of decision-making, higher efficiency of operations and leadership and better control of operations.

### 6. The purpose of management accounting in achieving organizational goals

Today, organizations have different goals and may be even qualified to a combination of goals. Thus, no comprehensive and uniform rule can be developed for all organizations [14]. The goals which are frequently emphasized by the organizations include:

1. An acceptable level of profit (profitability)
2. Growth
3. Financial self-sufficiency
4. Market Diversity
5. Social Services
6. Observation of social responsibilities

Regardless of which one of the above points are considered by the organizational objectives, the

management's duty has been to ensure of achieving goals.

Today, unstructured and unconsidered achievement of the goals involving changes in structural and technological elements and functional goals and patterns, makes the organization undergo crisis and stagnation for various reasons. Following factors have made it difficult for today's management to develop the organizational goals:

- As an open system, the organizations are exposed to serious effectiveness from the surrounding and internal environment. Factors and elements such as the increasing technological progress, economic developments, intertwined and complex commercial networks, difficulties in meeting the market needs and passing through winding path of competitions, have made the rules and regulations overseeing the function of the organization's goals achievement more difficult.

- Today's organizations are faced with the phenomenon of conflict between the various components forming the whole system i.e. their subsets and subsystems. This conflict which occurs as a results of factors such as difference in perception and cognition, ideas and norms, goals and values and attitudes of managers, the interdependence of various sectors of the organization's activity, confusion in roles and responsibilities and so, is an inevitable trait which must be controlled or resolved through management's strategy.

- As a dynamic phenomenon, the organizations are always subjected to changes. Mystery and key to escape from the problems and achieve goals of the organization in complex and difficult conditions is the rational management plan which will be possible by relying on reassuring data. Meanwhile, the management accounting system is one of the methods of providing information. Management accounting is a branch of accounting planned to meet the needs of the intra-organizational managers and administrators which will provide a variety of information regarding different financial and operational issues. This information which is prepared in the form of detailed reports, is interpreted, translated and used by managers and other users. Actually, it is worth mentioning that the success of management accounting depends on how much managers' decision making improves by presenting accounting information. Thus, providing information cannot merely help management in performing its duties, but the presented information must have the following features (e.g., relevance, timeliness, validity, importance, and comparability) to be used in decision making by the management. If management accounting fails to provide the information required

by the management with the required quality to be effective in management decision making, the mentioned system will have no effect but imposing costs to the organization. Thus, the quality of the provided information is of high importance and should be particularly considered.

Generally, the fundamental purpose of management accounting is to help the organization achieve strategic objectives. Realization of these goals meets needs of customers and the other shareholders. As a result, achieving these goals, the organization can preserve its position and distinguish itself from the other competitors.

Today most organizations face stiff global competition. To kee customers satisfied and meet the demands of other resource providers, contemporary firms must compete simultaneously on three dimensions: quality, cost, and time. These three elements form a strategic triangle. Each one is quite broad [13].

And it varies from one organization to another organization or from one product to another product (see figure 1).

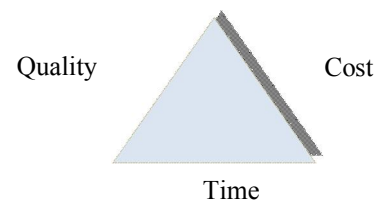


Figure 1: Elements of Strategy

- Quality is the total experience of a customer with a product. It includes the Physical characteristics of a product, such as its features, and the reliability of performance of these features. Quality also includes service features such as after-Sale support and service, and the performance level at which these services are Performed by an organization [1].

- Cost includes the resources expended by producers and their support organizations such as suppliers and dealers. Production costs encompass the entire "value Chain," that is, all parties from suppliers to after-sales service and disposers or Recyclers that create value for customers. Cost also includes resources expended by customers. Customer's cost includes the cost of maintaining and disposing of a product. This is often called their "cost of ownership".

- Time means that existing products must be available when a customer needs

them. Time also means that a firm develops products with new features or

Innovative technologies rapidly and takes these products to the market quickly. It also encompasses the time it takes to complete a cycle of activities such as start to end of production.

It should be noted that management accounting is not the goal, but it is important to achieve the goals of the organization. Management accounting helps the managers to assist the organizations in achieving the objectives and competitive advantage through collecting and disseminating information about the strategic elements.

Figure 2 captures this interactive relationship between organizational strategies, management accounting, and the daily activities of individuals in the organization. The information flows in both directions.



Figure 2: Role of Management Accounting in Strategy Deployment

In fact, providing the appropriate information, management accounting system helps the organization on quality, cost and time in order to achieve the organizational goals[2].

### 7. Accounting management and helping the managers

- Perception of cause and effect relationships: Management accounting can help the management in what has caused the cost or why there is an empty or useless capacity for production.
- Identifying activities that do not develop value added or are not efficient: Identifying inconsistent or repetitive activities or tasks that are not related to the customer needs, management accounting helps to redesign business processes.
- Understanding the relationship between different components of a value chain: management accounting information can show the impact of intermediate or supplier's activities on what the customer finally pays for a product.

- Identifying the process bottlenecks inside or outside the company: management accounting can show what components of the business process (machine or human) limits the efficiency of system and can cause customer dissatisfaction.
- Clarification of issues and changing the individuals' understanding
- Motivating managers and employees: Measurement of the components specifies the desirable behavior. People usually respond to these measurements
- Change of trends and directions: criteria which are surely of evaluation type will cause changes in levels of trends and efforts. For example, time standard for performing an activity specifies a goal that is expected to be achieved by reasonable efforts of the employees. In case of success, they will revise their effort level and, consequently, they will have a better performance next time.
- Change of relations: people tend to attribute success to their activities, but they attribute failures to the environmental factors. Research has shown that this attribution can change through management accounting criteria and finally can alter the behaviors.



### 8. Conclusion

Since management accounting has no similarity with financial accounting, a manager can select the tools and techniques that likes. Sometimes, this selection is successful and in other cases, it depends on the strategy of the organization. However, selection of the accurate strategy for the organization is a major factor. In addition, through the development of technology in the industries and the changes in production systems, the organizations have been faced with so severe complexities and changes that the management could not alone have enough knowledge about its environment in the organization. Therefore, it is essential that a system should be created in which it helps the management in identifying problems, setting goals, determining the issue precisely, defining possible solutions and evaluating these solutions and selecting, implementing, monitoring and evaluating an optimum solution. Management accounting information system has been developed in the same field; so that it provides an important part of the

information needed by management. Thus, the role of management accounting includes preparation, measurement and collection of financial and operational information which leads management activities and motivational behaviors and creates and supports the cultural values needed to achieve strategic goals of the organization.

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9/21/2012