Overview of a number of the principal problems on the management accounting of monetary crises

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Abstract

The monetary crisis has vital implications for accounting. This article provides an overview of a number of the principal problems on the management accounting implications of such crises; specific consideration is given to exploring the importance of and potential for research on this subject.

Key words: Management accounting, Crises, Monetary

Introduction

The current economic and financial crisis has significant implications for accounting, both for practice and for the research community. In the areas of financial accounting, auditing, management accounting and the regulatory institutions that oversee accounting and auditing practices there are genuine worries that the crisis has revealed numerous problems and inadequacies. In the academic and research community it certainly has illuminated issues that are in need of serious research attention. More than that, however, the crisis also points to the rather limited focus of much current accounting research. Too much intellectual inquiry in the area of accounting seems to operate within the parameters set by practice rather than questioning and challenging these, at least from time to time. Although the implications for research in accounting may not be so great as that within the finance research community where the serious lack of critical research is much more visible, a more detailed consideration of the implications of the crisis for accounting research nevertheless points to the need for a more rigorous investment in diverse research perspectives rather than an unquestioned following of a singular mainstream view.

The crisis is also encouraging more critical examinations of the managerial innovations that have emerged from the audit industry, not least its pursuit of the bureaucratisation of risk in the name of risk management. Coming through a crisis where risks have been real and perceived, increasingly it is coming to be seen that risk management mechanisms do relatively little to facilitate the real management of risk. Adding as they do to costs – and the income of the consultancies involved, by isolating rather than integrating the management of risk, the bureaucratic mechanisms still promoted by the audit firms and their associates provide yet further evidence of the relatively limited understanding that the audit industry has of real time management in action.

Trying to understand the crisis and reflect on its implications also illustrates the dangers of the drift away from the world of accounting practice that has been a characteristic of so much accounting research for the last few decades. Indeed at times it is possible to think that for some there has been a drift away from accounting itself: at the very least there has been a pronounced move towards studying accounting at a distance. As yet this has not been as severe in its implications as for those of our colleagues in finance research where increasing numbers have a very limited appreciation of the complexities of practice and its institutional context. There nevertheless has been a move away from analysing just such complexities and institutional contexts in the accounting area, often in the name of theoretical elegance and methodological rigour. Interestingly this is true for both statistically based capital market studies and a great deal of more critical theorizing. Of course theoretical and methodological issues are of real importance, not least in helping to avoid methodological capture by practice norms, frameworks and ways of looking at the world. But as numerous other social science disciplines illustrate, there are ways of balancing interests in the need for sound and reliable research with genuine interests in the complexities of practice. It really is important to understand how accounting has become implicated with the creation of new financial practices, with objectifying and simplifying the increasingly complex financial transactions that have emerged from an ever expanding investment in financial engineering. Equally significant is the need for a more informed understanding of the changes that have occurred in the influence structures in
the world of accounting politics both national and international, of the changing role that accounting plays in the informational environment of organizations and with how accounting changes in relation to shifts in the underlying nature of the socio-economic system in which business operates.

Consider the recent example of Alliance Boots in the United Kingdom. Boots is the largest retail chain in the cosmetics, health and pharmaceutical sector, having significant oligopolistic powers. Taken over by the US private equity firm KKR in conjunction with an Italian entrepreneur, the firm was so heavily leveraged by its new owners that it no longer made any profits and thereby avoided paying any profits tax in the United Kingdom (The Guardian, 2009). But the continuing management of the underlying financial surplus of the once profitable and tax paying firm is already resulting in redundancies, the elimination of lower price brands, a seeming increase in price levels and a shift of its headquarters from the UK to the Swiss tax-haven canton of Zug. Not only that, however. Boots has now pulled out of the Ethical Trading Initiative (Mathiason, 2009), allowing it much greater discretion in managing its supply chain to purely financial ends. All of these processes result in the movement of profits from the locales and regions in which they were generated to those of the financiers who have invested in the firm, potentially to the detriment of the former. In operating such a business in such ways, accounting is obviously of extreme importance, enabling the objectification and quantification of the dominant interest, its diffusion around the business, and management in the name of it.

Thames Water also provides another example of a United Kingdom company managed in the name of the short term financial interests of a concentrated ownership group. Once a nationalised utility, the monopoly is now owned by the Australian bank Macquarie. The company now makes record profits but it is still proposing to increase water charges by 17% above inflation over the next five years, with the largest increase of 10.5% coming next year. Whilst such rate changes are subject to the approval of the regulator, the company is in a very strong position to insist on the changes as it can otherwise threaten to radically reduce its investment programme, much of which is regarded as important for environmental purposes. Issues of sustainability, consumer interests and those of the work force and local communities are all likely to be set aside to enable the maximum extraction of financial surplus.

A multitude of other examples could be given, particularly in countries with an Anglo-American financial ethos. However although there is a growing awareness of such profit management and extraction processes, surprisingly little research has been done into the processes involved, technical and organizational. Yet some of the calculative technologies that have helped to operationalise the priority attached to both profit and shareholder value have emerged from the accounting research community (e.g. Rappaport, 1998) and the wider intellectual justification given to such single minded pursuits has also gained significantly from highly regarded researchers (for an overview by one of the most influential see Jensen, 2002; for a history of the development of the concepts involved see Lazonick and Sullivan, 2000). Such contributions, important though they have been for practice, nevertheless originated at a considerable distance from practice – providing a further illustration of research at a distance and the possible extent of its consequences. Although there are some inquiries into the actual functioning of such calculative approaches to management and their implications for both the firm and society at large (for an early example see Roberts, 1990; also see Froud et al., 2000), so much remains to be known about both the operation of such financial calculations and their infusion into the management of such enterprises. Already being called into question by both eminent practitioners such as Jack Welch (Guerrera, 2009; The Financial Times, 2009) and many researchers (see McSweeney, 2008), the current crisis should provide a strong rationale for much more serious investigation into this important area. Turning that rationale into research will not be easy however, not least because of access difficulties. As with auditing, practitioners are hardly likely to show any enthusiasm for knowing more about what they do and how they function.

No doubt there are a multitude of other implications and consequences of the current crisis for accounting. Faced with such an array of significant effects I decided to commission a series of short essays from a range of scholars reflecting on at least some of the issues that might be at stake for accounting and accounting research. Not everyone agreed, so not all aspects of the wider accounting agenda are addressed. Not all of those that did agree actually provided a commentary, further adding to the specificity of the views that did emerge. Taken together, however, the essays that follow provide a range of interesting and challenging observations on the contemporary worlds of accounting practice and research. The initial brief was for a short focussed statement. Some authors have kept to that while others preferred to offer a longer and more developed insight into their emerging views.

**Management accounting and economic crises**

One important area of accounting that is not covered is that of management accounting and the associated areas of management information and control systems. Yet the current economic crisis is putting enormous pressure on the functioning of management accounting systems in most organizations in the world. Everyday familiarity with both business and public organizations suggests that budgets are being continually set aside and reformulated. There are more and more pressures for restatements of expectations: are revenues likely to materialise, are redundancies inevitable and when and at what level, just what are the possibilities for radically changing cost levels, and so on. There has been a growing informational intensity around not only cash but the concept of liquidity, with the latter necessitating much deeper understandings of cash convertibility, asset
quality and so on. Strategies are also being constantly recast, illustrating in the process the importance of being strategic rather than merely having a strategy. Ad hoc analyses of a multitude of different aspects of the economic functioning of the organization are becoming a form of standard practice. Management accounting is moving to operating in continuous time. In these and many other ways economic information flows are assuming an ever greater salience in the management of organizational affairs.

Prevalent though such a state of affairs might be, it is nevertheless one that is poorly represented in the research literature whether at a descriptive or an analytical level. Although there have been a number of more general organizational studies, particularly in times of past crises (see for example Jick and Murray, 1982; Levine, 1978; Nottenburg and Fedor, 1983; Starbuck and Hedberg, 1977), management accounting research gives little or no guidance on the modes of organizational response to economic crises. Whilst there are literatures on the individual accounting systems and technologies which sometimes discuss the circumstances that might facilitate their use, there are few insights into what might be a more holistic organizational response. Is this a time for a greater informational intensity? How should the configuration of economic and financial expertise within the organization be mobilised and changed? Are there uniform patterns of such developments or are more contingent factors at work? Do the more successful survivors approach the mobilisation of economic and financial information flows in particular ways?

One early inquiry that did address some of these important issues was never published although it is mentioned from time to time in other literatures. Way back in 1975 the Swedes Olofsson and Svalander (1975) probed into the response of one Swedish organization to an economic downturn, albeit perhaps one that was not quite as severe as the present crisis. Nevertheless their findings are still fascinating. Terming the observed response “newly poor behaviour”, Olofsson and Svalander noted that the crisis resulted in an intensification of economic information flows within the organization. Financial information was reported in more detail, more frequently, for more organizational segments and units, and both systematically and in an ad hoc manner. The economic and financial aspects of the functioning of the organization were made more visible both absolutely and in relative terms. So whilst previously there might have been competing dimensions of visibility – operational data, social and human resource information, marketing intelligence, competitor intelligence and so on, as a result of the intensification of the internal economic and financial information, the alternative sources of visibility became relatively less significant. And therein lay a potential problem. For as Olofsson and Svalander pointed out, the economic crisis generating the difficulties for the organization was external to the organization. Adjustment to it most certainly required internal economising but it most likely also required different responses to the shifting external circumstances. The longer term adjusting, functioning and possibly survival of the organization required an externally oriented shift in strategy and corporate action, as well as a process of internal economising. Indeed it is possible that at the very time that there was an intensification of the internal economic and financial information flows there should have been an even greater development and intensification of the information entering the organization from its wider market contexts so that the overall balance of the information flows shifted to the external – where the real problems reside - at the very time it was intensifying the internal. In other words, a vibrant organization adjusting itself to an economic crisis is likely to be, at least temporarily, much more information intensive.

Olofsson and Svalander’s observations suggest that an organization that did not intensify the flows of external information in this way might well get ever more efficient, but efficient to the end it could still go to its financial grave because it had lost touch with its changing and crisis ridden environment. Survival and longer term effectiveness seemingly call for a more holistic informational response as suggested by the newly poor behaviour hypothesis. Intriguing though such a hypothesis might be, I am not aware that either it or the more general observation of the informational characteristics of organizations in crisis situations have been the subject of further research inquires. Not only was the original study seemingly never published, but other researchers have never been so fascinated by the more holistic patterns of information response to major organizational disturbances, crises or otherwise. While studies have been conducted of particular management accounting practices and systems, we do not seem to have developed a more sophisticated understanding of the cumulative functioning of an array of economic and other sources of information. It is as if the informational map of an organization has never been drawn.

The salience of a perspective similar to that of the syndrome of newly poor behaviour also emerged many years ago in a consultancy capacity. A former student knowing of my interest in understanding the informational characteristics of organizations and their embedding in the wider socio-political fabric of the organization asked if I would meet him to discuss a particular problem which his firm was facing with the development of its information systems.

Although lean and hungry, the company had nevertheless survived a particularly deep economic recession that had driven most of its major competitors into bankruptcy. The firm was now looking not only for ways to re-establish its markets but also for ways to economise on its existing operations so that it could generate funds for the renewal of its market position. One aspect of these changes was a considerable rationalisation of its information and IT systems with proposals for these systems to take over other internal operations that had previously been the province of different parts of the organization. Hardly surprisingly strong political opposition had emerged and it was this that had encouraged the former student to approach me. He thought that I could help him to solve the political dilemmas that he was facing. Talking the problem through, it seemed to me
that the changes proposed were predicated on only a very partial insight into the informational characteristics of the organization. Not only that, but it also appeared that changes in approach were being proposed without having any adequate insights into the characteristics of the organization that might have enabled it to survive when so many of its major competitors had not.

Presenting the resultant findings to the Board, at an early stage I was interrupted by an exclamation from one of the persons present. “Good God”, I still remember him saying. Asked to explain himself, he proceeded to say how another cost saving strategy under consideration was the movement of the corporate head office from London and the distribution of its staff around a number of other existing locations. Yet I had demonstrated how a very significant element of the continuous flows of market intelligence that seemingly had played a key role in the organization’s ability to adapt and adapt quickly to shifting market conditions had come from informal flows of information stimulated by the physical proximity of influential actors and departments. The surprised Board member had quickly realised that the envisaged physical move of the head office would have eliminated – or at least seriously damaged - the very flows of information that were now seen as being so instrumental in their survival and relative success. The company had indeed been an information intensive one but it turned out that a great deal of that intensity was informal and unstructured in nature. Yet their conception of information was only a formalistic one, reliant on systems and technologies, the very ones that they were proposing to extend at the very time they would have destroyed many of their informal ones.

The understandings of information and its management in that firm changed almost immediately. It was as if even the managerial practitioners had originally had a more distanced view of the information flows in their own organization. But their revised view made immediate sense and it gave them a new insight into at least some of the factors that had been of real but unrecognized significance in their survival. Subsequently they did elaborate their formal information systems and they even rationalised the head office, but not quite as severely as they had initially proposed. But all these later changes were done on the basis of a new insight into the informational map of their organization and the ways in which some aspects of information fed into their corporate functioning. A more complex conception of the organization had emerged.

Yet once again it would appear that relatively little research relates to such a holistic understanding of the informational aspects of corporate life, least of all in times of economic crisis. It is, however, an area of immense practical significance as these examples should serve to testify.

In the early days of Accounting, Organizations and Society it appeared as though research might move in this direction. The pioneering contributions of Jay Galbraith were illustrative of this. In Designing Complex Organizations (1973) Galbraith provided a framework for understanding some of the key factors that shape the information intensity of organizations and the variety of ways in which the demand for information can either be reduced or met. Based on reflections on his own experiences in Boeing, the framework provided a very insightful way of appreciating how different organizations with different cultures can and do respond to similar conditions and pressures in very different ways – something that certainly makes more standard forms of empirical analysis much more difficult. Galbraith also provided a way of gaining insights into the informational consequences of organizational changes, both internal and external. Following the dictates of lean production, for example, and reducing inventories and thereby increasing internal patterns of interdependence, can be shown to increase the demand for internal flows of information in order to manage the interdependency so created. At about the same time Grinyer and Norburn’s (1975) inquiries into the functioning of planning systems was one of a number of studies that reinforced the need for a more holistic approach to the understanding of informational processes in organizations. Although they found no significant relationship between formal information systems and financial performance, they did find that the use of more informal channels of communication, or information processes, were associated with higher financial performance as were the number of all information processes functioning in the organization. Lorsch and Allen (1973) equally found that the complexity of management information systems facilitated upward information flows, but not downward flows. However both upward and downward flows were found to be associated with favourable financial performance, thereby suggesting once again that alternatives to formal information systems are an important part of overall organizational functioning.

Other related studies were also undertaken around that time. It seemed as though a new perspective might be emergent. At some stage thereafter, however, such approaches to the wider informational analysis of organizations seemed to lose appeal. The attention of the research community shifted to probing into the operation and consequences of individual management accounting and information practices in isolation of their wider informational context, be they new approaches to costing, performance evaluation and management or whatever. I sense that the emergent approaches were too costly in terms of time, organizational involvement and the wider interdisciplinary knowledges that they required. We now live with the consequences of that, however, knowing relatively little of the overall design and functioning of an organization’s informational environment. One hopes that that will change – there are at least a few signs that it might (Kilfoyle, Richardson and MacDonald, 2008; Forporato, 2008).

Conclusion

Just as in the wider world there is a hope and expectation that the current economic and financial crisis might result in a degree of reflection, learning and real change, so the following group of articles together constitute the basis for a similar plea in
the area of accounting research. Hopefully by more closely observing and reflecting on both practice and its context and the changes that have occurred within them in recent times, the accounting research community might recognize the advantages of moving beyond their current focus on research at a distance. While more abstract conceptions or organizational functioning can be important, it also needs to be realised that many issues of real significance and importance can only be investigated by delving into the complexities of accounting in action. An improved understanding of accounting and its consequences does require an exploration of the functioning of accounting institutions, an understanding of the issues at stake in accounting change, an appreciation of the ever growing consequences of the commercialisation of the international audit industry and so on. Although there are a few signs that at least some accounting scholars are now recognizing both this need and its potential, intellectual change is not easy. Being aware of the constraints of the past and the careerist and institutional pressures behind them (Hopwood, 2007; 2008), one should not be too optimistic. But the crisis has been so real and so important that it might – just might – encourage a few to be more curious and more adventurous in their intellectual pursuits.

References
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