

MBA

**ACCOUNTING FOR MANAGERS
ASSIGNMENT**

By

Jonathan Simpson

Contents

Pg No		Contents
3	-	Discuss the extent to which the legal and professional regulatory framework of accounting ensures that corporate reports provide relevant, objective and comparable information to users?
8	-	Critically evaluate the contribution of budgets and budgetary control in ensuring maximum performance from employees and the extent to which this contribution depends on the level of employee participation in the budget setting process.
15	-	References
17	-	Bibliography

Word Count: 2494

Discuss the extent to which the legal and professional regulatory framework of accounting ensures that corporate reports provide relevant, objective and comparable information to users?

Each year companies produce a series of reports aimed at providing information that can be used by users to make decisions. There exist a number of users that can be determined of these accounts, who rely upon these reports to provide accurate information so as to make decisions. These users include the following: Equity investors; Loan creditors; Employees; Business contacts; Government; General Public; and Analyst-advisors¹. Groups as diverse as these will have differing information requirements, and this is reflected in the detail contained within the accounts. Some of the needs of these users may include: shareholders exercising governance functions; creditors who need to have a clear picture of the position and the prospects of their debtor; investors (shareholders and creditors) both actual and potential, who wish to know whether to acquire, retain or sell, a stake in the business; other stakeholders (including employees) and the wider public, who have a variety of relationships with the business². To ensure that the information provided in the accounts and reports reflect the users needs there are a series rules that govern their content. At present these rules are a mixture of statutory requirements, accounting standards (with a measure of statutory backing) and listing requirements. In between, there exist a number of “hybrid” guidelines, which combine self-regulation with legislative intervention³.

The basic statutory structure has changed little since the 19th century. All the accounting and reporting requirements are contained in primary legislation, principally the Companies Act. This Act specifically provides the overarching obligation on companies to prepare accounts to provide a “true and fair” view of the company position⁴. This obligation is further enhanced with the regulations laid down in the 4th, 7th and 8th EU Company Law Directives⁵. The 4th Directive includes – the “true and fair” principle, (which requires financial accounts to be accurate, not misleading, and sufficiently complete to enable fair appraisal of the financial position and profit or loss); basic accounting principles; more detailed valuation rules (for example as to how stock is to be valued or fixed assets depreciated); and detailed formats for the accounts. Combined these pieces of legislation provide some guidance for the presentation and format of the accounts and therefore, enable easier comparison with other company accounts. In addition, Part 7 of the Companies Act imposes the obligation to keep accounting records consistent with certain minimum disclosure requirements; requirements for making accounts available for inspection; reporting periods; the format for individual company and group accounts; and disclosure requirements in the notes to accounts. It further stipulates that financial statements must be submitted to the Registrar of Companies along with the Directors’ and Auditors’ reports. Directors must lay copies of the annual accounts, together with auditors’ report and directors’ report, before the company in a general meeting, send a copy of the accounts, together with the auditors’ and directors’ reports to every member and debenture holder⁶.

Whilst these statutory rules provide the means by which to enforce requirements of the accounts with respects to presentation and format, they are by no means comprehensive. Consequently the accounting profession has supplemented these guidelines with a range of detailed accounting standards⁷. These standards known as Statements of Standard Accounting Practice (SSAPs) were issued by the Accounting Standards Committee (ASC) up until 1990, which functioned as a self-regulatory body on behalf of the accountancy profession. This body however, lacked any statutory powers to enforce company compliance with SSAPs. In 1990, in accordance with the recommendations of the Dearing review, the standard setting process was given some statutory backing with the replacement of the ASC with the Accounting Standards Board (ASB). Not only is the ASB recognised by the statute as the body responsible for making, amending and withdrawing accounting standards, (where the ASC was not), but the standards are themselves given statutory backing. This was outlined in the Companies Act 1985 (as amended by the Companies Act 1989) when it required that companies, besides those in the small and medium-sized category, state whether accounts have been prepared in accordance with, and give any reasons for material departures from, the ASB's accounting standards⁸.

The ASB adopted the SSAPs designed by the ASC and added to and, in many instances, replaced these with the fuller and more up-to-date Financial Reporting Standards (FRSs). To date, it has issued 15 complete standards⁹. The development of accounting standards involves two formal rounds of consultation, firstly at the release of a Discussion Paper and secondly at the release of a Financial Reporting Exposure Draft (FRED). Where

inconsistent or unsatisfactory interpretations of accounting standards or Companies Act provisions arise, an arm of the ASB known as the Urgent Issues Task Force (UITF) investigates the situation and reaches a consensus on treatment of such cases¹⁰. These are published in abstracts, which are as binding as the other accounting standards. Therefore a full set of accounting standards (besides the accounting and reporting requirements of the Companies Act) are contained in the FRSs, SSAPs, and UITF Abstracts¹¹.

The ASB also collaborates with bodies from other countries on the international harmonisation of accounting standards through the medium of the International Accounting Standards Committee (IASC). The latter is an independent international private sector standard setting body, which was established in 1973. It has broad representation in its pursuit of uniformity in accounting principles and standards for financial reporting, and is presently restructuring itself into a truly global standard-setting body. So far it has issued a complete set of International Accounting Standards (IAS's), a task it completed at the end of 1998, presenting a truly self-regulatory initiative to achieve international harmonisation. Some countries lacking their own regulatory framework have adopted the IASs as domestic standards, whilst a recent announcement by the European Commission stated that it intends to introduce a legislative proposal to mandate International Accounting Standards (IAS) for all listed EU companies. Presently the UK, whilst part of the IASC's deliberation process, still requires domestic companies to comply with the ASB's regime, although foreign listed companies are allowed to prepare accounts according to IASs¹².

In addition to those requirements already discussed there are further reporting requirements stipulated by the London Stock Exchange's listing rules. Listed companies must issue a preliminary statement of annual results and the declared dividend by the company immediately after relevant board approvals, as well as the regulated release of any price-sensitive information¹³. The Listings Rules oblige companies to issue their statutory accounts within 6 months of the financial year-end. Such rules only apply to public limited companies.

In conclusion, the regulation of company accounting and reports is a “patchwork” of statutory and professional rules that are interwoven in an attempt to ensure that relevant, objective and comparable information is provided for the user. To date, the regulations that have provided the control of corporate and commercial accounting through a systems of norms and rules that have been promulgated either by governmental agencies or private actors, have worked. In combination they have managed to create a framework in which the users are able to extract the majority of the information from these reports required to make informed decisions. Whilst it remains impossible to fully satisfy every users' needs, the developments being made by the European Commission in adopting IASs and supporting them with legislation is a step towards greater uniformity of accounting in the EU, and more specifically the UK, which will result in the increased ease of comparison and extraction of information.

Critically evaluate the contribution of budgets and budgetary control in ensuring maximum performance from employees and the extent to which this contribution depends on the level of employee participation in the budget setting process.

Planning and control are major activities of management in all organisations. Central to these activities are budgets¹⁴. Over the years most organisations have accepted without question the principle that costs should be kept within budget and as low as possible, but not so low that key business goals are put at risk. However, in practice, managers often face unremitting pressure to increase resources to meet objectives such as better customer service and product quality. The importance of these objectives is reflected in the steadily increasing proportion of total costs accounted for by the overheads¹⁵. This upwards pressure requires effective management of overhead costs, rebalancing resources to reduce costs and improve services and quality. To do this management has embraced and promoted the principles and methods of budgeting and budgetary control as a part of normal business life.

This “historical” view of the importance of budgets is in contrast to emerging evidence published in a recent European survey that suggests annual budgeting cycle adds little value and takes too much management time¹⁶. It is also known that relying too heavily on budgetary control in managing performance has an adverse impact on manager and employees behaviour. That said, it is probably unfair and naïve to lay the blame for these weaknesses (and many others) at the door of ‘budgeting’, as the management functions now demanded were never intended to be delivered by budgets. Nevertheless the weaknesses are real; they are damaging to company performance and employee

motivation and need to be addressed. Since there now exists increasing concern over the effectiveness of budgets in ensuring maximum performance, their success may be directly linked with the level of employee participation.

Designed by accountants, budgeting principally is a mechanism for financial forecasting, managing cash-flow and capital expenditure and controlling costs. In essence, it facilitates managers in maximising profits by aligning financial resources to reflect changes in the costs and business requirements. In the past, budgets have been successfully used to drive down costs and control the function of the organisation, whilst maximising profit. However, in the changing world of business, more and more responsibility has been heaped on budgets to provide answers to management questions, causing a series of cracks to be exposed.

These weaknesses are more due to what budgets are not than what they are. Budgets were never the ideal vehicle for the management functions such as communicating corporate goals, setting objectives, continuous improvement, and resources allocation and as a basis for performance appraisal. These weaknesses are widely acknowledged and include¹⁷:

- Budgets cannot readily deploy strategy because it is applied organisationally.
- Budgets are not based on a rational causal model of resource consumption.
- Budgets fail to drive lasting improvement or generate congruent behaviour.
- Budgets are bureaucratic, take too much time and add too little value.

When considering these limitations it can be determined that most budgeting systems conflict with current management thinking and best practice, which recognises that processes must be managed across functional boundaries and, that performance improvement must be based on targets which are derived externally from customer needs and benchmarking and not as a consequence of the internal perceptions of these needs. It is of concern therefore, that whilst many companies are striving to improve their performance; the process of budgeting largely unchanged. In fact, budgets are still generally understood to form the cornerstone of management control, that they are a multi-purpose management tool supporting planning, control, co-ordination, communication, performance evaluation and motivation¹⁸.

Budgets can also influence management behaviour. When budgets are created, their purpose is to provide each department within an organisation the finances in which to operate. Scarce resources however, cannot always be ring-fenced within departmental divides, and with demand often transcending internal barriers. An example is provided by the following case study. The circulation manager of the newspaper wanted to curb long-distance and mobile telephone expenses. The assistant manager argued that these charges were justified to maintain a strong link between staff and field. They exchanged views and agreed that both links had to be maintained and costs reduced. They began to develop a program to identify unnecessary usage. The reduced use would not seriously harm communication between staff and field but would help everyone work more efficiently. Whilst in this example the conflict between budgetary departments is solved

this is not always the case, and more often than not the quality of service frequently suffers as a consequence.

What this example illustrates, and consistent with the argument of power and politics researchers, is the distribution of financial and other scarce resources among departments creates struggles and conflicts that challenge the image of an organisation as rationally and objectively unified entity¹⁹. This coupled with the politics and power plays to promote interests when securing budgets are problematic for the organisation, and can be detrimental to overall performance. Central groups that are critical for organisational success use their power to acquire the resources to continue to contribute significantly to the organisation, whereas, non-essential operations are sidelined or removed from the business. This being the case there are clear consequences for the motivation and performance of employees. It is not all bad though, as whilst destructive, the struggles for scarce resources and the conflicts engendered can help promote organisational adjustment and change and therefore increase performance²⁰.

Given that budgets can be so problematic in the way in which they are employed, the resolution of these conflicts is considered critical so that an effective distribution of resources equips groups to contribute to the organization and maintains employee commitment²¹. A study examining the theory of cooperation and competition to analyse conflicts as managers develop and adjust to both growing and shrinking budgets by Deutsch, argued that the management of conflicts depends on the conclusions that the protagonists make about the nature of their interdependence. He defined conflict

distinctly from interdependence as incompatible activities, where one person is interfering, obstructing, or in other ways making the behaviour of another less effective. He proposed that protagonists often conclude that their conflicts are competitive. However, they can also conclude that, though in conflict over scarce resources, their goals are predominantly cooperative or independent²².

What Deutsch advocates, is that when dealing with scarce resources that are budgeted there needs to be a greater level of management of the relationship between the employees and the entity of the organisation. His findings, that are consistent with the power and politics perspective²³, are that managers experienced more conflicts as they developed and adjusted their budgets, gives rise to his hypothesis that managers had to negotiate the distribution of the costs and responsibilities of joint projects and thus involve their employees in the setting of the budgets to maximise the “controlling” impact of the budget²⁴. This is further supported by Hofstede, when suggesting that participation by managers and employees would give budgets more legitimacy, leading to more realistic budgets being set and would improve motivation²⁵.

A final issue for motivation is whether the budget is achievable. No manager wishes to be stuck with a budget that cannot be met. Neither would an employee wish to work towards the unattainable. This problem is compounded by the variety of employees within an organisation possessing differing of views of budgets ranging from distaste, if they work in marketing or R&D, to one of a belief that budgets can be postponed indefinitely for “real” machine issues. What the former causes is a tendency on behalf on

the department manager to pad his budget whereas the latter, gives rise to budget-managers making ill-informed decisions regarding budgetary requirements of departments in the absence of the required information²⁶.

In conclusion, some companies are beginning to feel that budgets take up a great deal of management time but have little overall value. Most companies have not yet made radical changes to their budgeting practices, but a small number are now looking at alternatives.

In the main, companies are continuing to use budgets in not only the way they were originally designed, but increasingly to perform functions for which they were never designed. Since these new methods of budgetary control attempt to ring-fence departments within organisations they are diametrically opposed to modern day management concept of a unified entity. In doing so, these budgets, whilst created to influence and control the performance of employees are causing power and political conflicts within the ranks of the organisation. There is evidence to suggest that the conflict ensures that the most critical operations of the organisation survive, yet there is emerging clear and strong evidence to suggest that not only do the conflicts damage the quality of the product, but also wastes valuable time and effort, as budgetary padding appears to be the norm wherever top management demand that a budget is met. Theorists advocate that there is a need to move towards consultation and co-operation between employees and the organisation to ensure greater utilisation of the scarce resources budgeted. In doing so, overall employee motivation will be enhanced and therefore performance will improve.

The development of co-operation regarding budgets is not the only solution to the problems posed by budgets and budgetary controls. It appears that the budgetary cycles as businesses knows them will be faced with radical change over the coming years as companies grapple with ensuring that they provide a successful tool with which to create motivation of the workforce and thus ensure the desired performance. Developing these skills and goal interdependence may be an important way that managers can prepare their organisations to grapple with change, adjust and make their budget and other systems work, and distribute and use scarce resources effectively.

References

1. MBA Accounting for Managers Course Notes & Handbook
University of Leicester
2. Ibid
3. Ibid
4. Ibid
5. The Times, 15 June 2000 pg. 33
6. Companies Act 1989
Her Majesty's Stationery Office
7. Telcon 26 June 2000, ASB Customer Services
8. MBA Accounting for Managers Course Notes & Handbook
University of Leicester
9. Telcon 26 June 2000, Institute of Chartered Accountants
10. MBA Accounting for Managers Course Notes & Handbook
University of Leicester
11. Ibid
12. The Times, 15 June 2000 pg. 33
13. MBA Accounting for Managers Course Notes & Handbook
University of Leicester
14. Students' Newsletter – December 1998 Budgetary control – organisation aspects
Mike Tayles
15. Study Notes – BA Hons Defence Studies & Management (1990-2)
Captain J Simpson
16. Vuorinen, I. University of Tampere, School of Business Administration
Budgetary Control
17. Tjosvold, D. & Pooh, M.

18. Students' Newsletter – December 1998 Budgetary control – organisation aspects
Mike Tayles
19. de Latt, Paul B. (1994) Human Relations, 47, 1089-1119.
Matrix management of projects and power struggles: A case study of an R&D laboratory.
20. Koberg, C. S. (1987) Academy of Management Journal, 30, 798-807.
Resources scarcity, environmental uncertainty, and adaptive organisational behaviour.
21. Pfeffer, J. & Salancik, G. R. (1978)
The external control of organisations: A resource dependence perspective
22. Deutsch, M. (1973) Yale University Press.
The resolution of conflict.
23. Ibid
24. Ibid
25. Hofstede, G. (1968)
The game of budgets control.
26. Bunce, P.
The Chartered Institute of Management Accountants. 1997

Bibliography

Pfeffer, J. & Salancik, G. R. (1978)

The external control of organisations: A resource dependence perspective.

Pfeffer, J. (1981)

Power in organisations.

Koberg, C. S. (1987) *Academy of Management Journal*, 30, 798-807.

Resources scarcity, environmental uncertainty, and adaptive organisational behaviour.

de Latt, Paul B. (1994) *Human Relations*, 47, 1089-1119.

Matrix management of projects and power struggles: A case study of an R&D laboratory.

Deutsch, M. (1973) Yale University Press.

The resolution of conflict.

Vuorinen, I. University of Tampere, School of Business Administration Budgetary Control

Tjosvold, D. & Tjosvold, M. (1994)

Cooperation, competition, and constructive controversy: Knowledge to empower for self-managing teams.

Tjosvold, D. (1985) *Journal of Management*, 11, 21-37.

Implications of controversy research for management.

Wayne, S. J. & Rubinstein, D. (1992) *Human Relations*, 45, 525-536

Extending game theoretic propositions about slack and scarcity in managerial decision making.

Hofstede, G. (1968)

The game of budgets control.

Companies Act 1989

Her Majesty's Stationery Office

MBA Accounting for Managers Course Notes & Handbook

University of Leicester

Professional Ethics (1998)

The Institute of Chartered Accountants

Students' Newsletter – December 1998 Budgetary control – organisation aspects
Mike Tayles

Study Notes – BA Hons Defence Studies & Management (1990-2)
Captain J Simpson

The Times, 15 June 2000 pg. 33