

# *PERSPECTIVE OF A CMA*

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## RELEVANCE OF STRUCTURED COST MANAGEMENT IN CONTEMPORARY BUSINESS UNITS

**Introduction:** The world is changing fast, and so are the roles of accounting professionals. From the contemporary literature it is evident that there has been a definite shift from accounting for the balance sheet to accounting for the business & value creation. For cost and management accountants this shift is significant in bringing out a contextual perspective and as an aspirant cost and management accountant, this note has been prepared to provoke similar thought process among other cost and management accountants.

**Perspective:** THE CONTEMPORARY World Class Management Accounting (CMA) framework can be described as

- What Businesses are doing as an object of Management Accounting practices.
- Drivers of the new Management Accounting Order.
- Adopting a structured approach to Cost and Management Accounting in the contemporary pandemic inflicted era.
- The usage of Cost information was there in World war 2 when the economy was facing the cash crunch and treasure on Public goods and services. The European economy and other economy started using the usage of Societal and Cost Accounting. We are ready for the new future in societal cost accounting and managerial cost accounting.

The purpose of this article is to analyse the Management Accounting Practices in selected Indian business units and to see to what extent the above framework of Management Accounting is actually in place. Interestingly the usage of cost information, as it is understood today by us, dates back to world war II when economies were facing cash crunch and business units had to exercise lots of control on their costs and/or expenses. It will be beneficial to get an evolutionary view of the changes in Management Accounting practices

since the world war II, when the modern concepts of business competition really began to take a formal shape. This paradigm shifts noticed so far, will help us in understanding the relevance and significance of practices like cost audit. The perspective that is presented here is purely of a fresh CMA who is exposed to some of the contemporary

Management Accounting methods and tools known either through the books of auditee firms or through modern literature on the subject.

An interesting question is **“What has happened to the domain of cost and management accounting?”**

The question leads us to know >how it got originated and how it shifted its position over the period and what shape it has taken as on date especially in the context of the unprecedented COVID pandemic.

Simply put, the entire evolutionary process can be described as VUCA (Volatility, uncertainty, complexity and Ambiguity). The business environment, as much the economic environment, has been facing Volatility(V) of different kinds and varying magnitudes, Uncertainty (U) arising out of socio-political-economical shifts due to reasons like new technology etc., Complexity (C) arising out of expansion in market and globalization, and Ambiguity (A) due to emerging new alternatives before the decision makers. New Customer Demands, Commodity cycles, Government policies, Suppliers Risk and Traceability, Globalization and Regionalization, Global Economic Risk, are some of the reasons behind the VUCA. These factors prompted many governments to amend their policies for increased trade protectionism while many other took steps to accommodate the ever expanding supply chains. All these factors, inevitably, has had a significant impact on the management accounting practices of business managers.

The South Asian economies confronted, initially, a global as well as the domestic market that presented a huge demand for various goods and services, thanks to the paradigm shifts in socio and political environment. The response to this by the business units in these economies were to compete to produce to meet the maximum possible demand. Profit was the driving force behind managerial decisions and financial accounting thrived and grew to higher levels of perfection. Cost was an incidental information used for profit planning. One need not have a separate cost statement or a separate cost record. There was no appetite for the cost information. Profit was made easily by the companies and they needed only to churn out the production and send it to the market. The price was fixed more than the expenses incurred (often referred as cost) by the company. Huge profits were declared by companies.

An interesting analogy, for the shifts in the demand for cost information, is the well-known Darwinian theory on the growth of human species. Like in the growth of human species, the contexts for using cost information kept changing and that impacted growth in the demand for newer aspects of cost information.

So from a profit driven production decisions, that made cost information a small part of the overall inputs required for decision making, the nature of cost information required and used shifted to a context of resolving challenges of stiff competition in the market. When the competition started heating up, competitors wanted to crack the market and seize the opportunities of supplying to the increasing demand and thus attempting to take a larger share in the supplier driven market and this prompted emergence of discretionary cost items like Advertisement charges which necessitated some form of structuring the cost information/data.

Thus, the era of structured cost statement began. This period was followed by a move towards a Cost Accounting system for which the drive came from

changing Global environment especially in in 1950's and 1960's, pushing the need for accounting the Cost of Goods sold for Inventory valuation. The large sized enterprises like General motors, Ford, started with the responsibility accounting and Plant wise accounting, Plant-wise budgeting, transfer pricing etc. for a structured approach based cost accounting information to meet global competition that was slowly intensifying. Enterprises started framing Cost Accounting standards and such standards were slowly applied in other enterprises all over the world. The terms like overheads distribution, functional overheads, absorption of overheads etc. became important jargons in managerial decision processes. One observes such terms in the present cost audit framework, also.

The geo-political transformations in the world brought about many changes in various segments including businesses and economies. Enterprises started using terms like Zero Based Budgeting, Standard Costing, Marginal Costing, etc. These terms are collectively referred as "traditional cost accounting system" which was based more on accounting logic than the drivers behind incurring those costs. The end products' costs were held more sacrosanct and they influenced the behavior at the enterprise level as well as in the government regulations. The legal framework of present-day cost audit and cost accounting records rules, began in this period and took strong roots by supporting the framework through a designated profession. At the Government level, an ALL INDIA COST ACCOUNTING SERVICE was set up, thus ensuring fully system support to the defined cost accounting system.

But the business and economic transformations were taking place at an increasing speed and from mid-70's to end of 80's saw emergence of new Management accounting tools especially among enterprises in the USA, largely driven by competition from Japan-based companies. It was not merely an era of cost structuring and cost control (as was being perceived

in India), but also of emergence of newer tools to help taking superior decisions based on better cost and other information. The concept of “Operational Excellence” became a driving force and to connect the operational excellence in the field of Management Accounting, tools like TCM, Kaizen costing etc. emerged. Interestingly, Indian companies were oblivious to such developments largely due to the closed economic environment and less exposure to international trade. Indian enterprises continued to thrive in a sellers’ market by benefiting among themselves the opportunities thrown to them by the expanding domestic market. But, the limitations of a closed economy forced the economy to go for opening the economy to globalization and this, in turn, necessitated the enterprises to look for higher levels of strategic decision making.

Thus, the next stage in the “Darwinian theory”, very soon world class companies started adopting, “Competitive Strategies” as an important tool for structuring the costs and sharpening the decision making process. This was a period starting mid 1990’s, when globalization brought threats and opportunities in an unprecedented scale to the Indian companies. Companies were to evolve new strategies to combat competitive threats from operators across the borders especially because most of the operators successfully leveraged the existing competitive advantage to gain entry into Indian market. The Management Accounting mechanism was desperately required to provide cost and other information to appreciate the new threats like lower cost as well as more functionality in products and new opportunities like strategic alliances etc. Indian companies did respond positively and started gaining own competitive advantage in the global markets.

Surprisingly, the entrance of digitalization of market practices, manufacturing process etc. made the competition at the global level more complex and pushed in newer demands on Management accounting mechanisms. This Last stage of evolutionary process, which is the

contemporary scenario, is governance oriented and demanding management accounting systems of the organization to integrate with its IT systems, and the entire organizational processes. Top management teams, have started looking what is the real healthy cost and management accounting system that sustain the governance at the global competitive levels. This is how pre-pandemic growth expanded in the growth of Cost and Management Accounting field. The companies may experience different levels of impact due to the increasing complexity in the global economic environment, depending on the nature and structure of the organisation.

Let me Summarise the perspective merging from the above historical mapping of Cost and Management Accounting practices, especially in India:

- (a) If the company is a monopoly, the Organization has only to manage Profit and Loss account for Cost control tools to avoid wastes. Such companies either may be few or the scale of operation may be very low. The impact of global competition and related complexities would slowly shift the market positions of such companies which, in turn, would compel the companies to adhere to the emerging cost and management accounting practices.
- (b) If the company connects itself with Global operators, either in the supply chain or as competitors, the relevant issue is whether the company uses relevant Management Accounting tools like Marginal costing, Standard costing, Budgeting and also in the process of using tools like TCM, Kaizen, Balanced Scorecard etc. for ensuring operational excellence.
- (c) The companies coming under the point (b) above should ensure that complete strategic needs are built into the company's management accounting system. At this level the top management team is fully

synchronized with their company's cost and management accounting system.

(d) The Organizations have reached the stage where the Corporate management team reporting to the Board, take complete care in understanding the Cost and Management accounting.

(e) Auditors need to evolve innovative approaches to address the needs of the management to forward looking information. This would necessitate reformulation of various paragraphs under Cost Audit Report as prescribed under the Indian Companies Act, 2013.

**Conclusion:** The perspective outlined in above paragraphs have emerged from personal exposure of cost audit mechanism as it exists today in India as well various lectures on the subject by eminent persons at different international and national forums. Particularly, the lectures delivered by Mr. A.N. Raman, Cost Management Expert over the past few years have impressed on me to ponder over the relevance of the cost and management practices to the Indian companies. There seems to be an undeniable link between the emerging cost and management practices and the corporate governance which links the business world with socio-economic environment of India. Hence, I realised the need to share the perspective I have gained, among other aspirants to cost and management account who can share their thoughts on the subject and share to make this library section of the website of RNI, vibrant and useful

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