VALUE OF ACCOUNTANTS TO MODERN ENTERPRISE

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> "People must come to accept private enterprise not as a necessary evil, but as an affirmative good."
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> —EUGENE BLACK
> *Ex-President, World Bank*

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The Indian economy is undergoing rapid changes. There is considerable diversification and increasing specialisation. The responsibilities of management of Indian enterprises are, therefore, increasing in concrete spheres of activity such as marketing, accounting etc.

Broadly, an industrial enterprise can be divided into three major sectors: Production, Marketing and Buying. Such other sectors of activity like personnel management, research etc., important as they are, are ancillary to these three major sectors. The key to a successful enterprise is that in the operation of these three major sectors, the value of output should always be greater than the value of input. If, for example, Rs. 100 worth of input results in Rs. 100 worth of output, then the enterprise has no economic justification. It may be a social benefaction, but not an economic institution. Therefore, the need for obtaining a yield on resources employed is obvious.

Accountants play an important part in this process. Unfortunately at present, the equipment of our accountants is traditionally behind the needs of the time. Some change first occurred, mainly due to the Depression of 1930s. At that time, it was realised that more than anybody else, It was the accountant who could solve the problems of the industry in distress by proper advice. From then on the role of the accountant was no longer counted as the traditional one of mere book-keeping, but he began to be required to help industries to get tha best out of their employed resources.

We have a capital-scarce economy, and should be careful to get the maximum out of the capital employed.

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But, unfortunately, many enterprises do not have this consciousness. Some are even wasteful. For instance, there is often no proper co-ordination of buying raw materials, production and sales. The result can be a wastage of precious capital by tying it up in idle stocks of raw materials or finished product. In the context of our economy it may not only be the loss of idle capital but of imported materials and ingredients lying unused. An accountant, who is more than a book-keeper, can point out such waste.

It is good to see that the wind of change has begun to affect the accountants. Many of them today no longer wish to confine themselves to the traditional role of book-keeping. Their horizons are wider. They see the important role in all sectors of production in maximising output and profits and reducing wastage.

If a modern firm is to be efficient and forward looking, one essential is that its accounts and finance department must also possess the same attributes. This department has a real contribution to make towards the profitability of the Company in two ways : through an efficient book-keeping system that maintains historical and statutory records accurately and promptly, and by providing management with an efficient information and advisory service. The first task may be called maintenance accounting, and the second, management accounting.

In the old days, an accounts department was content with merely keeping the historical and statutory records in an efficient manner, but, important though these indeed are, *a* modern accounting department believes its real task to begin from there on; that it has not made its proper contribution unless it goes to the next and important stage of providing an efficient management accounting service.

Accounting management can help to streamline and simplify the day-to-day routine accounting, so that this is done with the maximum of accuracy and the minimum of senior management intervention. A system of controls and internal checks can be evolved to eliminate the chances of error and fraud and to enable the management to work on the principle of reporting by exception. This means that only

items calling for special attention are brought to the notice of senior management and not a multitude of routine matters. The enormous volume of clerical reporting, at one time thought essential, can today be reduced substantially but, of course, without impairing the necessary degree of control.

The basic principle which should be applied to management information is one of speed balanced against accuracy, and accuracy against its cost. For instance, the approximate results for a month may be ready and presented to the board, say, within ten days. If these results were to be prepared with meticulous accuracy, they would not be ready till the end of the following month, but what is prepared in ten days may be sufficiently accurate and reliable for the management to decide its course of action quickly. At the end of each quarter, however, a few more days can be taken to turn the monthly approximations into accurate results for the quarter.

Management Accounting is a term that has acquired an almost mystic quality in recent years. Many people think that it is something quite new and of necessity enormously complicated, involving an expensive system capable of comprehension only by experts. This is not true. It is neither new nor particularly complex. An able and understanding accountant, even in the old days, sometimes went beyond book-keeping and discussed with his management the implication of events and trends in the business in broad financial terms. In course of time, he developed a special advisory role where he was consulted on the moves the business had made and might make. This: in a perhaps more specialised manner, is really what management accounting boils down to. It is the role of the accountant. as an adviser or helper, instead of the "accountant" who feels his task done when the results are ready, or the "controller" who sees his task only in curbing management within the straight and narrow path of expenditure by the rule, unconcerned whether that expenditure produces the best results.

For modern conditions a management accounting system has, however, to be systematised and commensurate advantages are gained only if it is viewed as a whole and carefully planned to meet a particular management's needs. But it can start from simple beginnings and it must always be tailored to the needs of a business; it cannot be taken straight from a text-book and applied to an operation. Management accounting information properly and simply prepared is as readily intelligible to the businessman as to the accountant. A few vital and constructive figures, hand-written on a sheet of paper and clearly presented, may sometimes be better "management accounting" than an elaborate mechanical or electronic information system, which does not in reality go beyond book-keeping, or merely produces complex statements. The difference is in the approach of the accountant. Is he merely furnishing routine figures to his management, or a well designed service and advice?

It is sometimes argued that management accounting can wait in India : Indian business has not reached the stage where it can afford that luxury. I profoundly disagree with this view. For one thing, it is not a luxury; for a growing business it is a necessity, which should cost no more than any good accounting system. For another, if we are going to introduce in the country tha latest in plant and machinery and other techniques, it would be wrong not to get the! best out of them by matching them with the latest in accounting thinking. There is no merit in going through tha evolution in accounting techniques; we can start where the best have reached.

To illustrate the practical application of management accounting, I shall describe some of the main features of the system in the firm with which I am associated. It has its shortcomings but it is constantly trying to meet management needs.

By management accounting we understand the provision, analysis, reporting and discussion of accounting information as a guide to our management in the day-to-day running and future planning of the business, as distinguished from the recording part of the accounting function for historical and statutory purposes. Naturally, the recording function will often be the basis of the supply of management information.

A management accounting service can best be described as responsibility accounting. It reports information to different levels of management, suited to their responsibilities, who can take action or offer advice based on that information.

The sheet-anchor of our management accounting service is the annual estimate and budget for the coming two years. They forecast sales, production, capital expenditure, marketing, advertising and administration expenses, leading on to profits, yield on capital employed, and a cash flow prediction. They are prepared initially in terms of quantity as well as value at the lowest level of responsibility, where action is taken, and built upward along functional lines. They are finally brought to the board, at which each director presents the affairs and plans of his departments. These are, in fact, not forecasts but plans, because there is volition behind them and not just a futurity. They set the standards for the coming year, and performance is then reported against these standards, weekly, monthly, and quarterly, varying with the needs.

Following on from this major document, and flowing naturally from it, are a number of returns prepared at varying intervals catering to the special requirements of management. There is, for instance, a monthly profit and loss report to the board, weekly and fortnightly margins earned to marketing management, and daily raw material yields to production management.

For regular reporting to marketing management, we believe in the margin after variable costs concept. ,Variable costs are those which vary strictly with production and sales, and include raw materials and ingredients, packaging, excise duty and distribution. Other expenses like marketing and administration overheads, depreciation, repairs, direct factory labour, advertising and financial items such as interest, are only apportioned to groups of products and not to individual products. Although there are a number of methods for apportionment of fixed costs, they are invariably arbitrary and give widely differing results when taken to individual products and packs. Regular apportionment of fixed costs on an arbitrary basis is of limited value and can even be dangerous as it can mislead.

Price in a competitive market depends on what the consumer is prepared to pay, what competition will permit, and not solely upon the manufacturer's cost of production. As we operate in very competitive areas, naturally, the margin after variable costs of a group of products must be sufficient to cover all the fixed expenses of the group and give a reasonable return on the capital employed in producing and selling these products : but our week by week reporting on movements in the margin only reflects changes in the variable costs. This gives our marketing management realism and flexibility in their pricing policy.

We treat depreciation and direct factory labour as fixed costs in the short-term : depreciation because it will be a charge to the business for so long as we retain the assets, and direct factory labour because our policy is not to retrench staff during slack periods. However, when considering the costs involved in producing a new product or expanding capacity for an existing one, we look at the total additional or "out of pocket" costs involved, and these will include depreciation and wages. Also, when reviewing a group of products over a long-term, we assemble all costs directly applicable to that group. Some of this may be arbitrary, but is used only at a point of time and for a specific purpose, and does not form part of the continual appraisal of margins and performance, for which only the variable costs are taken into account.

Apart from reporting to marketing and production management about results and performance, our accounts department offers much service in the field of development of new packs, new products and new projects. Whenever our management thinks of something new, they turn to the accountants to study the financial implications. This, in short, is where the accountants and our general management together look ahead to make sure that a change or new development will produce healthy results. It should be

underlined that it is not the accountants who dictate the managers' policy; managers must make their own decisions, based upon the information they receive. And they may decide for other perfectly valid reasons to go ahead with the project which has a longer pay-back period or a lower yield : it may have broader economic or social objectives; but management must know where they stand and what they base their decisions on. This is where the accountant can help them.

So far as the organisation of the department itself is concerned, it is controlled by the financial director, who has reporting directly to him the chief accountant, the chief internal auditor and commercial managers in charge of our branch offices. But our accounts department is highly decentralised. The operating management of each unit, whether factory or branch, have their own accounts departments reporting directly to the unit heads. They discharge their responsibility for accounting records and also give advice on various aspects of accounts and finance when problems arise, and they are expected in general to be full and active members of the local management team. Head office accountants control them very little beyond ensuring that the basic principles are uniform throughout the Company, and the small amount of information they supply to head office is prepared in a manner comparable between units.

At the head office there is the chief accountant's department, which has no line relationship with the unit accountants. Its task is to handle general matters like consolidated budgets, annual accounts, taxation, finance, management salaries, pension and provident fund, and the maintenance of day-to-day head office accounting records. Much of the time of the chief accountant's department is spent on specialist service of one kind or another to central marketing and technical management.

Organisation and Methods, commonly known as O. & M., is a specialised department within the chief accountant's department. It concerns itself principally with the improvement of office systems throughout the Company. Clerical systems are often created to meet an urgent or immediate need, and the tempo of modern business is such that once the need is over and even the situation changed, the people operating the system are so busy with the day-to-day operations that they seem never to have time to review the system or to test its efficiency. Each time there is a new demand a modification is usually made, so that over a period the system is encrusted with layers of forms and routine which may have lost their original justification.

In the circumstances, it is not surprising that O. & M. men can be welcome visitors to a lively manager. Their job is to examine the documentation and work flow from basic principles and take nothing for granted. They ask what is needed, why and when, and they devise a system tailored to meet the special needs of the department which would give the results in a simple and efficient way. Theirs is a patient job of skill in "selling" themselves.

The internal audit department is an important part of our finance and accounts group and the chief auditor reports directly to the financial director with unfettered powers of free and frank criticism. Its prime responsibility is to see that the systems and controls are functioning smoothly and that there is no abuse or fraud; but in fact it goes much further. Divorced from the heavy day-to-day routine of departmental respunsibilities, it runs over a department's general functioning and makes objective appraisals of where systems and practices may be improved. It will not sit down and design detailed improvements, but having pointed an area requiring improvement or strengthening may suggest that O. & M. be called in.

We have of course our statutory auditors from outside, who state whether the accounts report correctly and fairly the state of the Company's affairs. But internal auditors go still further. Being part of the Company, they have responsibility for suggesting improvements that will increase earnings, increase efficiency and reduce expenditure. They in no way interfere with the rights and duties of the statutory auditors, who are in fact helped by the assurance of a good internal audit system.

An active duty of the financial accountants is to keep the cash constantly on the screen as it flows through the Company's veins and arteries. They watch and report on its movements every week, and with the help of the operating management make monthly, quarterly, annual and five-yearly forecasts. Cash, if its flow is not carefully watched, can soon get tied up in little pockets and lie unused or not used to the best advantage. The accountants and operating management must always keep it on the move to where it is most needed. It must neither be allowed to form clots nor drain away.

Equally, a watchful eye is kept on the capital employed in both fixed and current assets through quarterly estimates and actuals, and on the return the management is obtaining upon the capital so employed. To make it more realistic, for the purpose of this exercise, the fixed assets are not taken at their net book value, as shown in the Balance Sheet, but on the basis of their current replacement value, with a suitable adjustment for depreciation based on this replacement value. Its realism lies in the fact that it takes into account the changes in the value of money and shows the capital employed in the business by management on present day value. After all, the historic value of money is not of relevance and in an economy even as mildly but continuously inflationary as ours a management has to be alert to any depreciation of money.

It is obvious that management accounting will have to play a vital role in the growth and efficient functioning of Industry. The country needs men of quality in accounts; men who will feel active participants in management and not just providers of a service. Professional skill is important but more important are qualities of management, leadership and imagination. During their development they should be exposed to the broadening influence of spells in marketing, branches and factories, so that they learn to feel part of a team. The accountant should feel that he is helping with the running of the operation, and when working on a new project the excitement of looking ahead. In fact, all accountants shauld feel that they are sharing in the running and the progress of the country. But they must also realise the change in times if they are to seize the opportunities that lie ahead of them to help increase the nation's productivity and prosperity.

The views expressed in this booklet do not necessarily represent the views of the Forum of Free Enterprise

Based on a talk delivered under the auspices of the Forum of Free Enterprise in Bombay,

"Free Enterprise' was burn with man and shall survive. as long as man survives."

—A. D. SHROFF

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