

Accounting Objectives and Reporting System Construction of Managerial Accounting in China

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Abstract: The purpose of this paper is to propose an innovation system of managerial accounting reports, which is actually on the basis of accounting objectives. On the one hand, as managerial accounting is one important branch of accounting (the other important branch is financial accounting), some of its characters should be closely connected with accounting. On the other hand, managers need managerial accounting information for enterprise operation (especially for internal management control) decisions, so, managerial accounting should also be in accordance with the enterprise's operation and its management control. Therefore, combined with the existed research of accounting (especially financial accounting research) and for the development requirement of Chinese enterprises, this paper will mainly discuss the relation between accounting objectives and managerial accounting's system and put forward an idea of constructing an applicable reporting system of managerial accounting based on the operation mode in Chinese modern enterprises. This study will develop the accounting reports research (including external reports and internal reports) both in the field of theory and that of practice.

Keywords: accounting objective; accounting relevance; accounting report system; managerial accounting report

1 Introduction

In practice, Chinese enterprises went through a series of reforms (including the innovation of accounting standards) one after another during the time of China changing from a centrally-planned economy to a free market economy, which promoted the development of accounting (especially financial accounting) and its reports system of the Chinese enterprises step by step. Under the influence of this complicated economic climate and accounting development conditions, business operation and managerial accounting of Chinese enterprises showed different characteristics, such as various operating characters, different requirements of management control, varied reports system of managerial accounting, etc. from one period to the next, which caused some problems of accounting relevance as well.

In the respect of theory research, because people paid more attention to the external reports for meeting the needs of external shareholders (such as investors, debtors, governments, etc.), the development of financial accounting preceded that of managerial accounting and led to an extremely unbalanced development between financial accounting theory and managerial accounting theory, which

made the problems of accounting relevance aggravated also.

Furthermore, as suggested by Zhang & Liu (2010), developing the theory of internal reporting and constructing a systematic framework of it on the basis of accounting relevance theory is very important for related research improvement (both from the respects of application research and theoretical research). Therefore, this paper first analyses the relation between accounting objectives and accounting reports; then, it reviews the evolution of financial accounting objectives and financial accounting reports; thirdly, it defines the managerial accounting objectives and lay down the rules of the evolution of managerial accounting based on them; finally, to construct a four-level innovation system of managerial accounting reports on the basis of the management decision levels in Chinese modern enterprises.

2 Accounting objectives and accounting report

Main objective of accounting's is to provide useful information for decision-making, so the usefulness of accounting information is a basic quality characteristic of accounting. Both relevance and reliability of accounting in-

formation are indispensable to the usefulness of accounting information in decision-making. Generally, accounting relevance refers to the information provided by accounting, which can meet the needs of different decision-makers in decision-making; accounting reliability refers to the information provided by accounting, which can truly reflect the financial position and operating results. In respect of the circumstance that financial accounting and managerial accounting are the two branches of modern accounting, the objective of accounting information (i.e. decision usefulness), is not only suitable for financial accounting, but also proper for managerial accounting. If the accounting objectives can not suit the development requirements of financial accounting and managerial accounting at the same time, or one of them could not in accordance with the decision-making objective of accounting, it will cause the disharmony between accounting objectives and accounting behaviors.

At present, there are two kinds of misunderstanding in the research on accounting objectives or on the quality of accounting information: one is to emphasize the reliability of accounting information too much, while ignore the relevance of accounting information; the other is to only focus on financial accounting objectives or financial accounting information quality, while neglect the managerial accounting objectives or the managerial accounting information quality.

For one thing, the phenomenon of emphasizing reliability and neglecting relevance is caused by the followings: on the one hand, it is due to the deluge of false accounting information; on the other hand, the relevance is treated as a vested thing that the information users can only accept it passively. In fact, accounting reliability is not only under the influence of accounting technology, but also affected by the environment, such as social morality, culture, legal system and institution, etc. Therefore, it is impossible for accounting itself to solve all the problems of accounting reliability and the issue of accounting relevance should be studied mainly by accounting, which is a problem that accounting should and must solve.

For another, the phenomenon of emphasizing financial accounting objectives and neglecting managerial accounting objectives is caused by the misunderstanding of accounting objectives (especially misunderstanding of accounting relevance objective). Accounting relevance is reflected in a wide range of the decision-makers' requirements, and different decision-makers may need different accounting information. Generally speaking, decision-makers could simply be divided into external and internal deci-

sion makers, and accounting relevance could be reflected in two ways: one is that to meet the needs of external decision-makers; the other is to suit the requirements of internal decision-makers. Therefore, the former forms the objective of financial accounting, while the latter would be the objective of managerial accounting, in other words, it means that the usefulness objective of accounting not only includes accounting information reliability and relevance, but also involves financial accounting objective and managerial accounting objective.

Usually, accounting objectives would be achieved by following the procedure of accounting recognition, measurement, recording and reporting, and the accounting report is the final representation of the accounting information quality (or is the most direct reflection of realizing the accounting objectives). Therefore, in order to achieve accounting objectives, accounting report systems must be established and improved so that the relevance and reliability of accounting information could be comprehensively reflected in accounting report. As has been analyzed, accounting objectives can be divided into two categories, i.e., financial accounting objective and managerial accounting objective. Furthermore, financial accounting report can be used to achieve financial accounting objective, namely to meet needs of external decision-makers for accounting information; managerial accounting report can be used to achieve managerial accounting objective, namely to meet needs of internal decision-makers for accounting information.

Nowadays, financial accounting objective and financial accounting report are getting more and more concerns, while managerial accounting objective and managerial accounting report have been ignored for a long time. However, managerial accounting objective and managerial accounting report are the important research topics and areas which should not be neglected. So based on the managerial accounting objective of relevance, we will research on managerial accounting report systems for achieving managerial accounting objective effectively. As the studies of financial accounting objective and report are more advanced than managerial accounting research, we will analyze the evolutionary process of financial accounting objective and report before we make a study of managerial accounting objective and its report through getting inspiration and learning from these existing research foundations.

3 The evolution of financial accounting objective and financial accounting report

Financial accounting report is a document that re-

flects the financial position and operating results, the users of financial accounting report include owners (or investors), creditors, managers of in organizations (such as enterprises), and officials in government management departments or social supervision departments. From the perspective of accounting information relevance, the objectives and reports of financial accounting are always in line with the users' requirements for financial accounting information. The relation between financial accounting relevance and financial accounting report may be examined by the evolution of financial accounting report systems. The evolution of China's financial accounting statements experienced the process from cost reports to income statement, from statement of resources and application of funds to balance sheet, and from statement of changes in financial position to cash flow statement. Every change in financial accounting report (or financial accounting statement) is to meet the needs of accounting objectives for relevance.

A. From the cost report to the income statement

The cost report had been the most important accounting statement from the founding of People's Republic of China in 1949 to Reform and Opening- Up in 1978. As China's economic system was a planned economic system or executive order economic system during this period, the decisions about production, distribution, or consumption were made by planning authority of government, while government didn't treat economic efficiency and value as main objectives. Therefore, enterprise management only focused on yields, varieties, qualities and costs. From the perspective of accounting relevance, only the cost level had the biggest effect on business stakeholders' decision-making.

Then, from Reform and Opening- Up in 1978 to the middle of 1980s, China's economic reform goal changed for establishing a planned commodity economic system, so enterprises could not only lay emphasis on production and cost any longer, but also should pay attention to supply, marketing, and pursuing revenue and profit, therefore, the content of enterprise management was extended from production management and cost control to revenue management and profit management. The needs of enterprise management for accounting information were bound to be extended from cost information to income statement information, which includes revenue, cost, and profit. Naturally, income statement had become the most important accounting statement at that time.

B. From the statement of resources and application of funds to the balance sheet

In China, before the middle of 1980s, the statement

of resources and application of funds reflected the accounting balance formula—the source of funds equal to the application of funds, and played a role such as the trial balance that is earmarked as a fund only for its specified purpose. In the late of 1980s, with the separation of government from enterprises and the separation of ownership and management, enterprises' goals were not only the revenue or profit, but also linked the indicators (such as profit) with the usage of assets. Therefore, the usage of assets in the statement of resources and application of funds, was related closer with the decision-making. During this period, enterprises treated assets as enterprises resource to input, and managed asset allocation, asset restructuring, asset usage, etc. In this case, enterprises pursued not only for the profit maximization, but also for the value-added of asset and profitability maximization. So, it was obvious that enterprises not only concerned about the income statement, but also paid attention to assets in statement of resources and application of funds.

Since 1992, China's reform has been at a new stage that socialist market economy is establishing. At the same time, the direction of enterprise reform is to establish a modern enterprise system, which is to be clearly established by property right ownership, well defined rights and responsibilities, separation of enterprises from government and scientific management to adapt to the requirements of the market economy. So, the operating characteristics of modern enterprises are operation and management, which is focused on value-added of capital, and taking return on capital as the core of management. Therefore, the statement of resources and funds application is not in sufficient for making management decisions any more, furthermore, the balance sheet is bound to replace the statement of resources and application of funds in Chinese enterprises. A new area of modern management has been opened up by combining the income statement with the balance sheet, especially combining the net profit in income statement with the equity in balance sheet, namely capital management—a fashion management mode in Chinese modern enterprises.

C. From the statement of changes in financial position to the cash flow statement

The statement of changes in financial position is a dynamic accounting statement, which can analyze the information for reflecting the inflow and outflow of funds according to the changes in assets and equities of enterprises in a certain accounting period. Actually, the statement of changes in financial position was used in The United States in the 1960s, and was taken the place by cash flow

statement in 1987. In order to meet the requests for the financial liquidity and the preserved and added value of Chinese economic system reform and Chinese enterprises' system reform, the statement of changes in financial position was added to accounting statements in China in 1993. The statement of changes in financial position was prepared on the basis of working capital, and the changes in capital of other important business were taken into account at the same time. Moreover, such statement directly provided information related to ensure the effective use of funds.

However, with the development of the market economy, it was gradually found that the statement of changes in financial position based on working capital could not provide accurate information of enterprises' ability to the

as accounting assumptions, accounting standards, etc. Therefore, the relevance and the reliability of accounting request for adding notes to accounting statements and supplying an explanatory memorandum of financial condition in addition. The adoption and continually changes of accounting reports in China indicate the requirements of accounting relevance need for changing contents of financial accounting report.

In summary, the evolution history of financial accounting report has shown the impact that accounting relevance objective makes on financial accounting report. The accounting relevance objective is changing with the requirements for decision-making of economic system and enterprise system, and accounting report is also bound to change with it. (See fig.1)

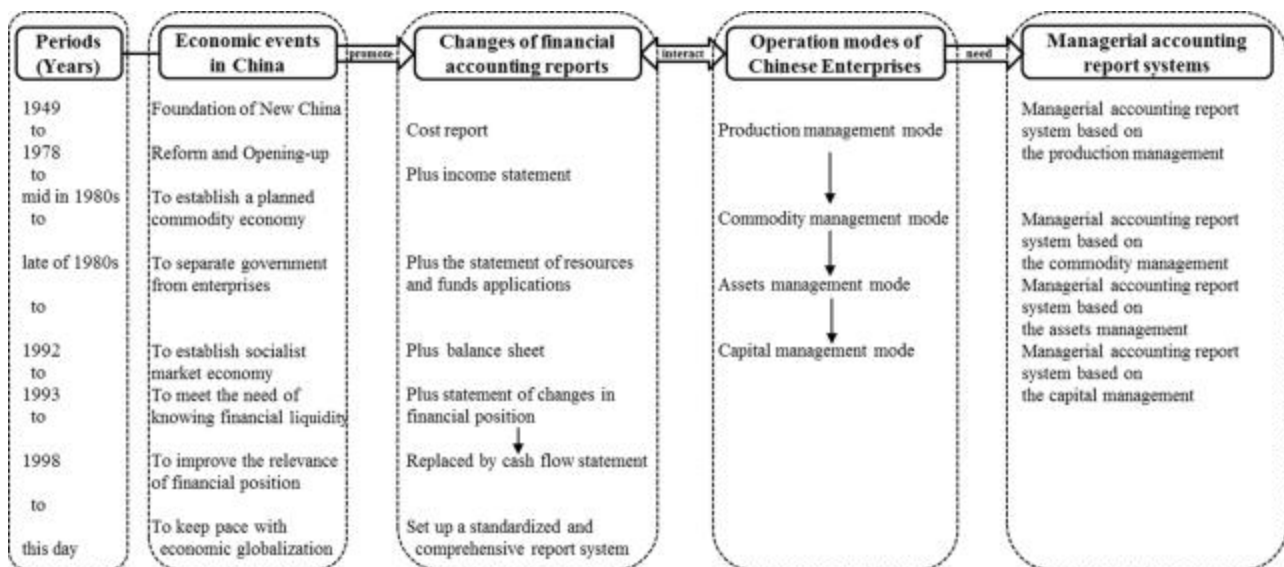


Figure1. Evolution of financial accounting report in China and its relations with the innovation of managerial accounting report systems.

payment, the quality of assets, and the quality of profits. While the cash flow statement, which is the statement of changes in financial position based on cash flow, can provide accounting information related to decision-making better, therefore, the cash flow statement succeeded in replacing the statement of changes in financial position in 1998.

D. From the accounting statement to the notes of accounting statement and financial condition explanatory memorandum

The main accounting statements, including balance sheet, income statement and cash flow statement, comprehensively reflect the financial status and operating results of enterprises or other organizations, but cannot provide specific detailed information for stakeholders, because it is restricted by inherent characteristic of accounting, such

4 The objectives of managerial accounting and the principles of managerial accounting report innovation

The main users of managerial accounting reports are board of directors, managers and employees of enterprises. As managerial accounting reports are written documents for reflecting the process status and results of enterprise operation, they usually involve various accounting statements and the notes used in enterprises for internal decision-making, controls, evaluation and communication. Although China's enterprises produce a number of management statements, such as the cost statement etc., while the main purpose of preparing these statements is to render a service to the final accomplishment of financial accounting reports. Therefore, for Chinese enterprises, the

managerial accounting reports are not the issues of improvement, but the issues of innovation.

Similarly, the innovation of managerial accounting report can not be separated from managerial accounting objectives, in particular the relevance of managerial accounting. From the perspective of the internal management requirements for Chinese enterprises, the accounting relevance is to provide all kinds of information (especially the accounting information) for managers to make internal decision-making, to control, to evaluate and to communicate in their daily work. This is a matter of fact that the enterprises have to take it into account of managerial accounting reports and the innovation of managerial accounting. Therefore, the research on the relation between managerial accounting objectives and managerial accounting reports should begin with the research on the relation between managerial accounting reports and related reports on the basis of accounting relevance, which determine the principles and ideas of managerial accounting innovation.

The basic principle of managerial accounting report innovation is to make it sure that the information of managerial accounting report, which is needed for internal management, is closely related with the information of decision-making, controls, evaluation, and communication. This relevance calls for a proper treatment of relations between two of the following contents, especially when we establish managerial accounting report systems. (See fig.2)

tion, managers' decisions must be always consistent with investors' interests. Therefore, the information provided by managerial accounting report is bound to be closely related with the information provided by financial accounting report; while the reliability of managerial accounting report is the basis of the reliability of financial accounting report at the same time. The relation between managerial accounting report and financial accounting report requires that the establishment of managerial accounting report systems should be led by financial accounting report, which could ensure the relevance and the reliability of financial accounting report through the process of achieving the relevance and the reliability of managerial accounting report.

B. The relation between managerial accounting report and budget report

In terms of the service object and the objective of managerial accounting report, one importance of what managerial accounting report differs from financial accounting report is that managerial accounting report can provide the information of internal control (especially the information of process control) for enterprises' internal management. Furthermore, internal control could be carried out in many ways, such as the methods of the system control, the budget control, the motivation control etc. Taken the current control environments and the objectives of managerial accounting report of Chinese enterprises into consideration, it indicates that the budget control is a

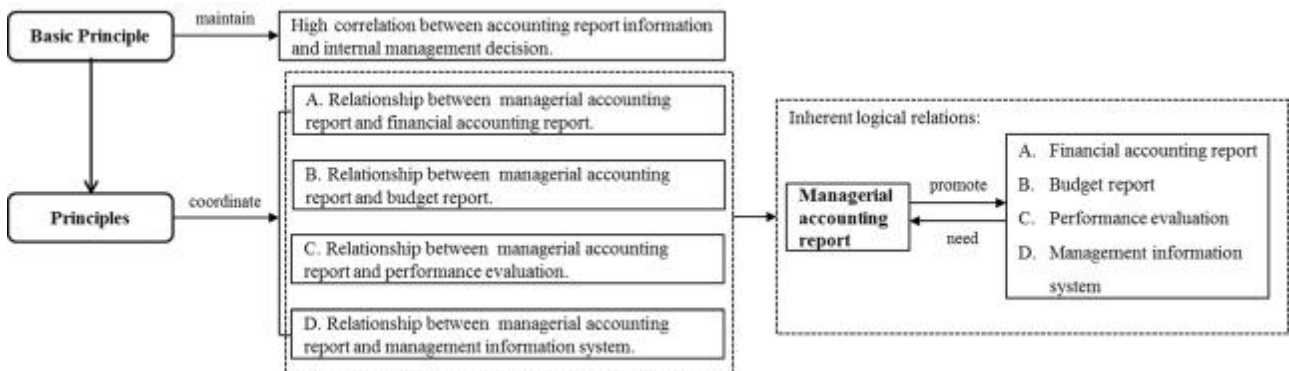


Figure2. Principles of the innovation system of managerial accounting report.

A. The relation between managerial accounting report and financial accounting report

Generally, the purpose of managerial accounting report is to provide the information related with decision-making for the internal stakeholders, compared with the purpose of financial accounting report, which is to provide the information related with decision-making for the external stakeholders. As the relation between internal stakeholders (especially the managers) and external stakeholders (especially the investors) is a principal-agent rela-

tion, managers' decisions must be always consistent with investors' interests. Therefore, the managerial accounting report system should be established on the basis of budget control and handle the relation between managerial accounting report and budget report properly, then make the managerial accounting report playing the role of budget control inside the enterprises.

C. The relation between managerial accounting report and performance evaluation

One of the information functions provided by managerial accounting report is to evaluate the business perfor-

mance of the staff (such as managers, employees, etc.), which is often evaluated by the responsibility centers and the responsibility indicators. This requires the division of responsibility centers should be considered when we design the managerial accounting report systems, and the evaluation of responsibility indicators (related with the staff's behaviors) should also be considered when we detail the content of managerial accounting reports. Only when the relation between managerial accounting report and performance evaluation is handled properly, that the managerial accounting report system would present it is directly related to the interests of controllers and those being controlled, and it gives a full play in enterprises' internal management.

D. The relation between managerial accounting report and management information system

As managerial accounting report is an accounting information system serving for internal operation and management of enterprises, it is an important component of the enterprise management information system. In management information system, managerial accounting report should be in dominant position because of the comprehensiveness and integrity of internal accounting information. However, when we establish managerial accounting report systems, the coordination and communication between managerial accounting report and enterprise-wide management information system should also be focused on in order to ensure the relevance, accuracy and timeliness of managerial accounting report systems and management information systems.

5 Conclusion and further research

In order to reach a conclusive result, we draw a diagram for showing the four systems of managerial accounting report systems clearly, whose logical relations and basic structures can be reflected directly in figure 3 that is as follows:

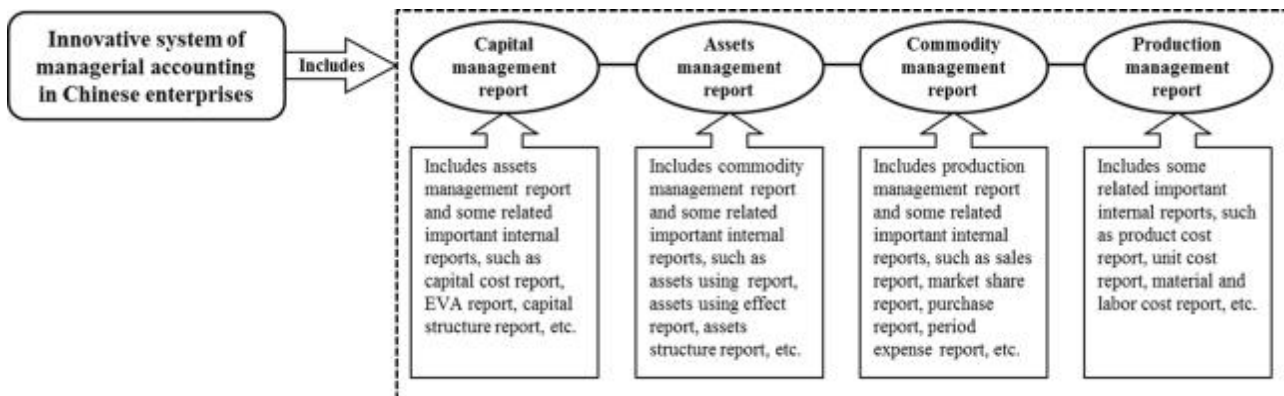


Figure3. Framework of managerial accounting report systems in Chinese enterprises.

In summary, influenced by the economic development in China, there are four major management (or operation) modes in Chinese enterprises (i.e. capital management, assets management, commodity management and production management), which are the basis of constructing the innovation system of management accounting as what we have analyzed in this study, management accounting system is also composed by four report systems, i.e. capital management report, assets management report, commodity management report and production management report, and they not only have natures in common (such as the nature of accounting relevance and decision usefulness), but also have characteristics in particular (such as different concerns and different indicators or indexes for achieving their detailed targets). Therefore, this research on reporting system construction of managerial accounting in Chinese enterprises, based on the analysis of accounting objectives and its relation with managerial accounting reports, is to not only be in accordance with the essential requirements of accounting information system, but also meet the various needs for different enterprises' development.

With this theoretical framework of managerial accounting reports, we will make effort to test its application value in the future research.

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