

# ADOPTION OF MANAGEMENT ACCOUNTING PRACTICES IN SRI LANKA: A REVIEW OF LITERATURE

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## ABSTRACT

The purpose of this paper is to explore the extent to which management accounting practices are adopted among recent empirical evidences reported on the adoption of management accounting practices of listed companies in Sri Lanka. This paper therefore reviews seven recent empirical studies conducted in Sri Lanka on the adoption of management accounting practices. The review finds that nearly all studies have used survey method except a case study. All studies reviewed have concluded that companies listed in Colombo Stock Exchange (CSE) adopted more traditional management accounting practices at different level of adoption. The study further observed that there are considerable differences at the level of adoption of contemporary management accounting practices between multinational companies being operating in Sri Lanka and indigenous companies of Sri Lanka. The deviation is due to the contextual factors such as size and origin of the organizations. Therefore, this study suggests for future researches on management accounting practices adoption, determinants and their effect on performance on manufacturing sectors as well as among the other sectors especially service sector which is now growing very fast in Sri Lanka.

**Keywords:** Management Accounting Practices, Level of Adoption, Listed Companies, Sri Lanka

## Introduction

Management accounting practices (MAPs) are the tools or techniques which generate information that assists managers with their planning, coordination, monitoring, and evaluation of the activities of the organization and its members. Every business organization must adopt MAPs regardless of the size, market and operation.

Since, the neoliberalism in late 1970's, global competition increased dramatically. The increased global competition is accompanied and underpinned with rapid technological development and advanced manufacturing system which influenced many aspects of the industrial sector. Therefore, the design, maintenance and interpretation of information systems became considerably important in effective management of organizations. The challenge for management accountants, as the primary providers of information, became to ensure through the use of process analysis and cost management technologies to provide appropriate information to support managers and employees at all levels (Abdel-Kader and Luther, 2004) at the same time, this situation shifted them to focus on creation of value through the effective use of resources.

During this period, scholars, particularly, Johnson and Kaplan (1987) questioned the relevance of contemporary management accounting practices. The main argument of Johnson and Kaplan (1987) was that management accounting did not follow the fast development of the organizational environment. In other words, there has not been sufficient change in management accounting techniques to match the changes in the organizational environment, and to support the growing demand for information. Johnson and Kaplan (1987) further stated that in general companies opted for internal information systems were mainly designed to meet the requirements of external financial reports. For this reason, they called for the development and implementation of new 'advanced' management accounting techniques.

Since then, advanced management accounting techniques such as activity-based costing (ABC); activity based management (ABM); life cycle costing; target costing; quality costing; functional cost analysis; throughput accounting, strategic management accounting; shareholder value techniques; economic value added (EVA); the balanced scorecard (BSC); and supply chain management (SCM) have been developed and introduced in the management field. Further to this, the propagation and promotion to adopt these contemporary management accounting practices within the organizations over the world were intensified by accounting academia, professional accounting bodies, business consultants and international funding agencies (for e.g, Cooper & Kaplan, 1988; Bromwich & Bhimani, 1989; Guilding, Cravens & Tayes, 2000; Langfield-Smith, 2006); Scapens,

2006a; 2006b). Further, they have acknowledged that the adoption of contemporary management accounting practices (CMAPs) within the organizations become crucial because the information it provides is essential for companies' survival in a competitive environment.

However, the level of adoption of the contemporary management accounting practices (CMAPs) among the organization is not as prescribed. There is variation in the level of adoption of CMAPs as high, moderate and low among deferent companies across different countries. This is observed from the studies of developed countries such as, Europe (for e.g. Drury, Braund, Osborne, & Tayles, 1993; Anderson & Lanen, 1999; Laitinen, 1995; Israelsen, Anderson, Rohde & Sorensen, 1996; Bruggeman *et al.* 1996; Pierce & O'Dea, 1998; Szychta, 2002; Hyvonen, 2005; Abdel-Kader & Luther, 2006), U.S (for e.g. Shields *et al.* 1991; Chow, Cooper & Waller, 1988), Asia-Pacific (for e.g. Scarbrough *et al.* (1991; Yoshikawa 1995; Chenhall & Langfield-Smith, 1998).

In the meantime, the studies from developing countries acknowledged somewhat different findings. The companies originated from developed countries and established their operations in developing countries in the form of multinational or joint ventures are adopted more sophisticated and CMAPs than the companies originated from local. For example to see the studies from China (Firth, 1996; Islam and Kantor, 2005; Wu *et al.*, 2007), Middle East, (Alnamri, 1993; El-Ebaishi, Karbhari & Naser, 2003; Leftesi 2008), South East Asia, (Ghosh & Kai Chan (1997) in Singapore; Phadoongsitthi (2003) and Nimtrakoon (2009) in Tailand; Joshi (2001) in India; Waweru, Hoque & Uliana, (2004) in Africa; Frezatti (2007), in Brazil).

Hence, the scholars concluded that though management accounting is important to the organizations, management accounting has changed much more slowly than necessity to fulfill the demand for information in present organizational environment (Johnson and Kaplan, 1987; Burnes *et al.*, 1999; Scapens *et al.*, 2003; Scapens, 2006; Sorensen, 2009).

Though there have been empirical studies in Sri Lanka investigating the adoption of MAPs within the private companies the findings of such works have not been documented. The objective of this study is therefore to explore the level of adoption of different MAPs of listed companies in Sri Lanka.

## **Research Design**

The primary idea of this study is to explore and document the empirical works done on the level of adoption of different MAPs of listed companies in Sri Lanka. This study is a literature survey of prior empirical works related to the adoption of MAPs in Sri Lanka. Various journals, and books which are available in the online databases such as JSTOR, Wiley, Scopus, Science Direct, Springer, SAGE, Taylor & Francis and Emerald were searched to collect the literatures related to this topic. In addition, Master level and PhD level theses were also explored in the libraries of Sri Lankan Universities. On line search had been done with the keywords such as management accounting practices, adoption level, Sri Lankan organizations and Sri Lanka. With the results of both online database and manual library search, this paper identifies seven recent empirical studies conducted in Sri Lanka on adoption of MAPs. Papers taken for review include Fonseka, Manawaduge & Senaratne (2005), Subasinghe & Fonseka (2009), Fonseka (2012), Gunarathne & Lee (2013), De Zoysa, Bhati, & Zoysa (2014), Gunarathne & Alahakoon (2016) and Kariyawasam (2018) are reviewed in this research. Reviews of such papers are documented in the following section.

## **Review of Recent Management Accounting Practices Literature in Sri Lanka**

Fonseka, Manawaduge and Senaratne (2005) studied the adoption of MAPs among 47 quoted public companies' representative of six industry sectors: Beverages, Food, and Tobacco, Hotels and Travels, Plantations, Manufacturing, Chemicals and Pharmaceuticals and Construction in Sri Lanka using questionnaire survey. A list of 36 MAPs were categorized into 5 groups such as formulating business strategy, planning and control activities, decision making, efficient resource usage, performance improvement and value enhancement and internal control. Each of these MAPs were positioned on a two-dimensional grid bounded by Stage of Development of the MA Practice and the Associated Function based on Nishimura's Four-Stage Development Model of Management Accounting (1995) and the Chartered Institute of Management Accountants' definition of the scope of MA (2000). The four stages were drifting, traditional, quantitative and integrative stages. The findings of this study indicate that more use of MAPs is reported within the functions of planning and control and internal control while with respect of other functions such as strategy formulation, decision making, efficient resource use, and performance improvement and value enhancement the use of MAPs are reported very little across different sectors. Further, the study indicates that MAPs among the Sri Lankan organization surveyed seem mainly in the Drifting and Traditional Stages the phase of advancement. The finding further state that few companies use MAPs that belong

to the Quantitative Stage. In addition, the finding of this study pointed out that comparatively higher degree of MAPs is used by the multinational companies from Beverages, Food and Tobacco Sector and the Chemicals and Pharmaceuticals Sector and few of such companies use practices belonging to the Integrative Stage than local companies. The existence of a considerable gap between MA theory and MA practice is also found in this study.

Further, Subasinghe & Fonseka (2009) observed that the use of MAPs in the Sri Lankan business sector is at a very low level. They do not use management accounting proactively. In their study, they had compared the MA practices between local companies and multinational companies. Their finding indicates that most of the multinational companies use most of the MA techniques and they treat the role of a management accountant as extremely important.

In addition to these, Fonseka (2012) in his unpublished PhD research stated that most of the Sri Lankan manufacturing companies did not adopt sophisticated management accounting practices. Further he states that the companies which have introduced sophisticated management accounting practices are multinational companies being operated in Sri Lanka whereas the indigenous companies are low in sophistication of management accounting practices. The study covered 47 listed manufacturing companies that engaged in manufacturing, viz., Chemicals and Pharmaceuticals, Beverages, Food and Tobacco, Manufacturing, Footwear and Textiles and Construction and Engineering. And it classified each of MAPs into four levels of IFAC's four stages.

Gunarathne & Lee (2013) examine the reason, and the extent to which, a service sector organization (hotel) at Sigiriya in Sri Lanka which has adopted and implemented environmental management accounting practices (EMAPs) practices. Using the case study method, data were collected by conducting semi structured interviews with General Manager, Accountant and employees relevant to EMAPs. Further, Accounting records such as *Green Book*, daily and monthly material and energy records, online resources and various other documents were analyzed as secondary sources of data. Analysis performed using *explanation building* approach reveals that the hotel had reinvigorated its environmental management practices in an urgent, cost-saving bid when faced with a financial crisis. Their finding further reports that the hotel continuously improves and sustains the EMAPs using a *holistic approach* by obtaining the support of various stakeholders with a clear vision. The study concludes that the findings of this study could not generalize to all service sectors due to the contextual factors surrounding the research site.

De Zoysa, Bhati, & Zoysa (2014) examines the extent to which various traditional and modern management practices are used by business organizations in Sri Lanka. The finding from the survey conducted on 55 listed companies reveals that conventional cost and management accounting techniques such as budgeting, standard costing and cost-volume profit analysis are frequently used by most of the Sri Lankan companies and it is also being with varying level from low to high. Further, the finding indicates that many companies are still reluctant to use the modern cost management tools such as activity-based costing, balanced scorecard and lifecycle costing. The study further reported that the reason for lower use and development of various effective cost and MAPs is due to the more importance given to the use of financial accounting-based reports for decision-making in Sri Lankan business organizations.

Gunarathne & Alahakoon (2016) studied the diffusion of environmental management accounting practices (EMAPs) within the private and public indigenous Sri Lankan enterprises. The finding of this study shows that the large private sector companies follow several common EMA practices in the areas of energy, material, water, carbon, etc. in Sri Lanka and also a rapid diffusion of EMAPs reported among the Sri Lankan indigenous enterprises in many different industry sectors. The author further concluded that though there are rapid diffusion of EMAPs, a comprehensive and systematic adoption of EMAPs in Sri Lanka is not found. This study suggests that the Sri Lankan organizations can get more advantages through the appropriate adoption of EMAPs in future.

Kariyawasam (2018) examined cost management and account management practices of listed manufacturing companies at Colombo Stock Exchange (CSE) in Sri Lanka. Using sample of seventy companies representing 5 manufacturing sectors namely, apparel manufacturers, beverage, food and tobacco, chemical and pharmaceutical, footwear and construction and engineering, data were collected from Chief Financial Officers using survey research strategy and applied research method study report that the activity based costing is the main costing method used by public quoted manufacturing companies in Sri Lanka, followed by process costing and job costing. The study also reported that cost information is mainly used for pricing related decisions while customer

profitability related decisions, and performance measurement are being next to this. Further, the use of cost information for product related decision among the manufacturing companies is relatively low. The study also indicated that the reason for the increased interest and use of cost accounting is due to the decline in firm profitability, increasing cost, intense competition, and high customer and supplier bargaining power within the public quoted manufacturing companies in Sri Lanka.

## Discussion and Conclusion

This study sought to review selected recently reported empirical researches on extent to which the rate of adoption of MAPs in Sri Lanka with the objective of exploring common findings articulated therein. The summary of the recent empirical literature relevant to the adoption of management accounting practices are presented in table –1. It is observed that Sri Lankan empirical studies on adoption of MAPs have comparatively preferred survey method except one case study approach. Researches have employed different list of MAPs. Notably, all most all studies have used manufacturing companies as the samples of their studies except one study. All studies under reviewed have concluded that all most all the companies listed in CSE have adopted management accounting practices for their planning, decision making and performance evaluation thereby confirming that management accounting practices are significant for their business operations and strategic planning. However, the level of adoptions varies based on the size and origin (multinational and indigenous). Further, it can also be observed from the conclusion of the above empirical work that the adoption of traditional management accounting practices is widely used when compared with contemporary management accounting practices among the listed companies specially in manufacturing companies where as multinational companies operating in Sri Lanka have adopted sophisticated or contemporary management accounting practices. It thus creates a need for future research on management accounting practices adoption, determinants and their effect on performance on manufacturing sectors as well as among the other sectors especially service sector which is now growing very fast in Sri Lanka.

Table 1: Summary of Recent Literature on Adoption of Management Accounting Practices

Author/(s)	Sample Size	MAPs	Major Findings
Fonseka, Manawaduge & Senaratne (2005)	47 firms drawn from six major sectors of manufacturing listed in CSE.	A list of 36 MAPs that were developed and categorized into 5 groups such as formulating business strategy, planning and control activities, decision making, efficient resource usage, performance improvement and value enhancement and internal control.	<ul style="list-style-type: none"> <li>• MAPs are mostly used for Planning and Control and Internal Control purposes.</li> <li>• Lower usage exists in other functions such as Strategy Formulation, Decision Making, Efficient Resource Use, and Performance Improvement and Value Enhancement.</li> <li>• Use of traditional MAPs are more among local companies whereas use of few advanced MAPs are among multinational corporations.</li> <li>• Considerable gap between MA theory and MAPs found.</li> </ul>
Subasinghe & Fonseka (2009)	22 listed companies in CSE	Not clearly mentioned	<ul style="list-style-type: none"> <li>• Use of MAPs in the Sri Lankan business sector is at a very low level and are not in proactively.</li> <li>• Multinational companies operating in Sri Lanka use most of the MA techniques and they treat the role of a management accountant as extremely important.</li> </ul>
Fonseka (2012)	47 listed manufacturing companies	Four management accounting systems sophistication levels based on Abdel Kader and Luther (2006) IFAC's model.	<ul style="list-style-type: none"> <li>• Most of the Sri Lankan manufacturing companies did not adopt sophisticated management accounting practices.</li> <li>• Multinational companies operating in Sri Lanka adopted sophisticated MAPs whereas the indigenous companies are low in sophistication of management accounting practices</li> </ul>

## Reference

Gunarathne and Lee (2013)	One Firm from service sector (hotel)	Environmental management accounting practices (EMAPs)	<ul style="list-style-type: none"> <li>Adopted EMPs in an urgent, cost-saving bid using a holistic approach.</li> </ul>
De Zoysa, Bhati, & Zoysa (2014)	55 companies listed in CSE	Traditional cost and management accounting techniques and modern cost and management accounting techniques.	<ul style="list-style-type: none"> <li>Traditional cost and MAPs such as budgeting, standard costing and cost-volume profit analysis are used with varying level of use from low to high.</li> <li>Most companies are reluctant to use the modern cost management tools such as Activity Based Costing, Balanced Scorecard, and Lifecycle costing.</li> <li>More emphasis given to the use of financial accounting-based reports for decision-making.</li> </ul>
Gunarathne & Alahakoon (2016)	Number of sample is not indicated	Environmental management accounting practices in the areas of energy, material, water, carbon, etc.	<ul style="list-style-type: none"> <li>Large private sector and indigenous companies of Sri Lanka adopted several environmental management accounting practices in the areas of energy, material, water, carbon, etc.</li> <li>A comprehensive and systematic adoption of environmental management accounting practices in Sri Lanka is not found.</li> </ul>
Kariyawasam (2018)	70 firms drawn from 5 major sectors of manufacturing companies.		<ul style="list-style-type: none"> <li>Costing method used by Sri Lankan manufacturing companies are activity-based costing.</li> <li>The cost information is mainly used for pricing decision, customer profitability decision and performance measurement.</li> <li>Planning and control, budgeting, target costing, and cost-volume-profit analysis are used as the traditional management accounting practices.</li> </ul>

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