Accounting Historians Journal

Volume 12
Issue 2 Fall 1985

Article 7

1985

James O. McKinsey

Tonya K. Flesher

Dale L. Flesher

The Accounting Historians Journal
Vol. 12, No. 2
Fall 1985

Tonya K. Flesher
and
Dale L. Flesher
UNIVERSITY OF MISSISSIPPI

JAMES O. MCKINSEY

The first book on the subject of budgeting, and the first textbook on managerial accounting, were both authored by James O. McKinsey, a professor at the University of Chicago. Before McKinsey, internal users of accounting information were largely neglected by educators.[1] Only through years of practical experience could a young accountant hope to master the knowledge needed to profitably use management accounting information. McKinsey also authored the first edition of what later became, according to industry sources, the most successful accounting principles textbook in America. Unfortunately, McKinsey's name does not appear in much of the current literature on accounting history.

He was also one of the main contributors to the development of accounting education in the United States during the first third of the twentieth century. He became president of the American Association of University Instructors in Accounting, the predecessor of the American Accounting Association, in 1924 when only 35 years of age. One noteworthy aspect of his year as president was that conferences with representatives of the American Institute of Accountants resulted in accounting instructors being accepted for membership in the Institute. Previously, Institute membership had been limited to practitioners.[2] This milestone is especially noteworthy because educators had been seeking admission for nearly a decade.

McKinsey made another significant change in 1923, when vice president of the American Association. Prior to that time, accounting educators had always held their annual meeting in conjunction with that of the American Economic Association. However, in 1923, McKinsey made the decision to break with tradition and hold a separate annual meeting in Columbus, Ohio. He believed that the Association's major base of support was in the Midwest, and that the central location was preferable to the East Coast site that had been selected by the economists.[3]

McKinsey also played a role in the establishment of *The Accounting Review.* In 1923, he became chairman, and William A. Paton, and Thomas H. Sanders were named members, of the Association's first Committee on Publications. The Committee's charge was to determine whether a quarterly publication should be issued by the Association. McKinsey and Paton constituted the majority favoring publication. Subsequently, McKinsey defended the Committee's position at the annual meeting in Columbus with a variety of arguments that Hiram Scovill called one of the outstanding events of the Association's first quarter century.[4] Despite the fact that McKinsey was an early leader of the American Accounting Association and a pioneer in developing budgetary control, managerial accounting, a managerial approach to finance, and accounting education in general, he has not yet been inducted into the Accounting Hall of Fame; nor is he much discussed in accounting retrospects.

Although his contributions to the field were many, McKinsey's career in accounting education was rather short. Following his year as president of the American Accounting Association's predecessor organization, he changed his interest from accounting to management. In 1925, he founded McKinsey and Company, consultants, and in 1926 became a professor of business policy at the University of Chicago. His professional contributions continued, and in 1936, he was elected chairman of the American Management Association, an organization he helped organize. In 1935, McKinsey completed a management consulting engagement for Marshall Field & Company, the large Chicago department store chain. The Board of Directors was so impressed with his work that he was hired as chief executive and chairman of the board. The last three years of his life, 1935-1937, were spent with Marshall Field & Company. McKinsey died at the early age of 48.

The Early Years

James O. McKinsey was born in Missouri in 1889. In 1912, he received a Bachelor of Pedagogy degree from State Teacher's College in Warrensburg, Missouri. A year later he obtained a law degree from the University of Arkansas. McKinsey's interest in business education was noted even by his law student colleagues at Arkansas. The "Class Prophecy" predicted that McKinsey would someday buy out Draughon's Business College (a large chain of business schools) and change the name to McKinsey's Business College.[5]

McKinsey's accounting career began in 1914 at St. Louis University, where he studied and taught bookkeeping. Although he already had a bachelor's and a law degree, McKinsey decided to enter the School of Commerce at the University of Chicago where he subsequently earned both bachelor's and master's degrees. He received his master's degree in 1919, the same year that he passed the Illinois CPA examination. Before he had completed his degree program at Chicago, George E. Frazer, a professor of accounting, asked McKinsey to join the accounting faculty. This was typical for McKinsey, starting with his high school, as he claimed that he was hired to teach in every school that he attended, before graduating. Frazer also hired McKinsey to work in his public accounting firm (Frazer and Torbet), and sent him to New York, to establish an office of the firm there. During his time in New York, McKinsey lectured in accounting at Columbia University. In 1921, he returned to the University of Chicago.[6]

He began his prolific writing career in 1919. One of his first publications was a teacher's guide to the Revenue Act of 1918. In 1920, he and A. C. Hodges wrote *Principles of Accounting,* published by the University of Chicago Press. Also in 1920, McKinsey published the first volume of *Bookkeeping and Accounting,* followed by the second volume a year later. These two volumes were written for secondary school students.

McKinsey took a pioneering philosophy in accounting education through his emphasis on principles over techniques. He required students to view accounting as a manager rather than as a bookkeeper, and he believed that all educated people should be able to understand accounting data. McKinsey maintained that accounting was the equal of any university course in teaching students to reason analytically. He produced three more books in 1922: a case study of a manufacturing company; a two-volume *Financial Management;* and *Budgetary Control.*[7] His book on budgetary control is a classic of the subject now described as "Management by Objectives."

Budgetary Control

The period after 1920 was one of substantial and rapid growth in the use of budgets, and the publication of *Budgetary Control* provided considerable impetus. World War I and the resultant drive for efficiency provided added stimulus for acceptance of Mc-

Kinsey's work, which summarized experimentation to date to provide a complete budgetary program for industry. McKinsey's book was the first standard work on budgeting and the first attempt to cover the entire budgetary program.[8] He was aware that his book was a pioneer effort, and the first paragraph of the preface acknowledged that "this is the first attempt, so far as as the author is aware, to present the subject as a whole, and cover the entire budgetary program." In fact, before the publication of McKinsey's book, budgeting was not even considered applicable to business operations. With respect to the popular conception of budgeting at that time, McKinsey stated:

> In the past, budgetary control has been considered primarily in connection with governmental units. There has been much interest manifested in the budget of the national government. . . . As a consequence many people have come to think of budgetary control as an instrument for governmental administration. Not only is this the popular view but practically all the literature on budgetary control is confined to a discussion of governmental budgets. . . . It is the purpose of these chapters to show that the principles of budgetary control are as applicable to the individual business units as to the governmental unit, and to explain the method by which these principles may be applied.[9]

McKinsey noted in the preface that he was indebted to his partner, George E. Frazer, for his counsel and assistance. A secondary source[10] speculates that Frazer was the source of many of McKinsey's ideas. Indeed, Frazer was McKinsey's professor, his department chairman at Chicago, and his CPA firm partner. Frazer was reportedly pleased with *Budgetary Control* because it followed outlines used in his seminar at the University in 1917 and 1918.

McKinsey's book stressed the fact that budgeting was a dynamic field in which all of the answers were still not known. In the preface, readers were asked to submit constructive criticisms to the author. Still, despite the fact that the book was a pioneer effort, it covered most aspects of budgeting. In 1945, *Budgetary Control* was included in a list of the twelve most indispensable books in the field of management.[11] The author of that selection apologized for including such an old book on the list, but stated that McKinsey's work had lost none of its value with the passage of time. In fact, there was little of current importance excluded from McKinsey's

Flesher and Flesher: James O. McKinsey

book about the budget as a planning tool, with the exception of flexible budgeting. McKinsey never mentioned this concept, although he repeatedly stated that unit costs would vary as volume changed. He did recognize the problem presented by changing production volumes:

> Estimates cannot be made which are entirely accurate, and consequently they must be used with judgment and not followed arbitrarily. It is also necessary that provision be made for frequent revisions of these estimates as actual performance shows variations from the estimated performance.[12]

McKinsey recommended revising budgets as soon as actual volume levels were known.

Flexible budgeting was not an important omission from McKinsey's system because he considered the budget more as a planning and communication tool than as a control tool (despite the title of the book). In fact, the communication aspects of the budget were probably McKinsey's greatest contribution. In effect, he saw the budget as a device to integrate all of the decision areas of business administration.

McKinsey's *Budgetary Control* was actually a compilation of several of his articles that had been published over the two preceding years. Although these articles had appeared primarily in *Administration* magazine, some were also published in such journals as *American Fertilizer* and *Cost Accountant.* The book was heavily based on McKinsey's consulting work and included numerous illustrations of factual situations.

Managerial Accounting

McKinsey's philosophy of accounting was that it should serve as a basis of functional control in a business. To serve in this way, accounting had to be more than merely a history of past results. Instead, accounting had to be able to show how the present came to be and what the future was to bring forth. Unlike most accounting educators of the time, McKinsey thought that "accounting, if it is to serve as an aid in administration, must provide information which can be used as a basis of action and not information which can serve only as a basis of repentance."[13]

Although McKinsey's first managerial accounting textbook was not published until 1924, he publicly espoused his philosophy of managerial accounting education in a 1919 article in the *Journal of*

Political Economy.[14] McKinsey was quick to criticize not only accounting educators for their stodgy methods, but public accountants as well:

> Too often the accountant in the installation of an accounting system regards the pro forma balance sheet and statement of profit and loss which he is accustomed to making at the end of the fiscal period as the ultimate goal of accounting and constructs his system accordingly. As a consequence, the accounting records too often do not serve as an aid in administration, but only as a means of providing postmortem evidence.[15]

McKinsey's 1919 article concluded that accounting education had been oriented toward night courses for bookkeepers. Consequently, primary emphasis had been placed upon the creation of accounting records. When traditional universities began to offer accounting courses in day programs, the same teaching methods were used that had been followed for decades in the evening colleges. However, day students were different from evening students in that only a small percentage of the former were destined to be public accountants. Many of them went into business management. Consequently, McKinsey (and the University of Chicago) recognized a need for accounting courses that would emphasize the uses of accounting data, rather than the preparation of such data.

McKinsey was such an advocate of the managerial uses of accounting that he took every possible opportunity to speak on the subject. Once, when asked to address a group of CPAs on the subject of municipal accounting, McKinsey stated that even though the subject was supposed to be a discussion of methods employed by municipalities to record transactions, time pressures permitted him to discuss only the managerial purposes and uses of municipal accounting data.[16] The emphasis of the speech concerned the role of the organization chart as a starting point in designing a municipal accounting system.

In 1924, *Business Administration* and *Managerial Accounting* were released. Both of these works were pioneering efforts in the respective fields of business policy and management accounting. *Managerial Accounting* was the first of an intended two-volume set; however, the second volume was never published.

In the preface to *Managerial Accounting,* McKinsey divided the subject into the following seventeen major topics:[17]

I. The Need and Nature of Standards and Records

Flesher and Flesher: James O. McKinsey

II. The Organization for Standards and Records Control
III. Administrative Reports
IV. Sales Control
V. Purchasing Control
VI. Traffic Control
VII. Production Control
VIII. Personnel Control
IX. Plant and Equipment Control
X. Branch-House Control
XI. Investment Control
XII. Control of Liabilities
XIII. Expense Control
XIV. Financial Control
XV. The Financial and Operating Program
XVI. Proprietorship Control
XVII. Profits Control and Distribution

Volume One covered the first seven topics. Several chapters were devoted to each topic. The remaining topics were to appear in Volume Two which McKinsey expected to publish within one year.

The preface to *Managerial Accounting* stated that it was now time to organize the business curriculum into one coherent whole. McKinsey justified this philosophy with the following statement:

> If the accountant is to be of most service to the business executive, he must understand the latter's point of view, and be able to present data of such nature and in such form that the executive can use it in the solution of his daily problems. Unfortunately the accountant and the business executive often do not appreciate each other's point of view or understand each other's problems. It is hoped that courses of this type will help to eliminate this difficulty.[18]

McKinsey also stated the pedagogical assumptions at the University of Chicago:

1. that all students in a college of business administration should have a basic training in accounting as a part of a well-balanced business course.
2. that the primary purpose of such a training is to teach the student how accounting can be used in the solution of business problems.

3. that this purpose can be accomplished most effectively by giving the student (a) an appreciation of the business problems which are customary to the typical business unit; (b) a working knowledge of accounting techniques; and (c) a thorough training in the use of accounting and statistical data in planning and controlling business operations.[19]

McKinsey's viewpoint, and that of the University of Chicago School of Commerce and Administration, differed from that of other professors of the time. Historically, a working knowledge of accounting technique (the ability to pass the CPA exam) had been the primary objective of accounting education.[20] McKinsey pioneered the emphasis on using accounting data. Even the problems at the end of each chapter were unusual, in that they could not be answered by memorizing the text. Most problems and questions required the application of textbook material to new situations. Unfortunately, McKinsey's philosophy did not permit him to sell many books. Neither Volume Two nor a second edition of Volume One ever appeared.

McKinsey's influence on managerial accounting education did not end at this point. William J. Vatter confirmed that he did have a very limited contact with McKinsey by visiting his course for half the summer of 1935.[21] Vatter stated that he did know McKinsey's *Managerial Accounting* and was probably influenced by it. Vatter published his own *Managerial Accounting* in 1950 in a preliminary edition which was reprinted twelve or thirteen times through the late 1950's; it was never widely adopted or republished in final form because the author became too busy with other projects.[22] In the preface, Vatter wrote that the book was the:

> product of much experimentation, in efforts made at the University of Chicago, to determine how the need of present and prospective managers for an understanding of accounting could be met. Since the answer to this problem is only tentatively drawn, the work is presented here in preliminary form so that it may be tested in other classrooms . . .[23]

Thus, even in the late 1950's, managerial accounting education was still in its infancy; McKinsey was well ahead in publishing a text in 1924. Some similarities can be found in the books of McKinsey and Vatter. Both emphasized control. Secondly, Vatter also included problems and cases, many based on real life situations, to develop independent thinking and to prevent mechanical application of the procedures described in the chapters.

Thus, McKinsey influenced Vatter, who in turn taught Charles Horngren. Horngren has dedicated each edition of his book, *Cost Accounting: A Managerial Emphasis,* to William J. Vatter and acknowledges his obligation in the preface. The Horngren book has been the standard for modern managerial and cost accounting education, and this work can be traced back through Vatter to McKinsey and the University of Chicago.

Other Publications

The year 1924 marked a significant turning point in McKinsey's career as his interest expanded from accounting and budgeting to managerial accounting. He was later to move away from accounting as he developed his interest in management. After 1927, he taught only business policy courses and devoted the remainder of his time to his consulting work, to the exclusion of research and other faculty activities. He was one of the first professors of business policy in America. Before his break from accounting, however, he did author *Accounting Principles,* which was published in 1929. This book was the predecessor of the texts by Noble, Niswonger and Fess, now authored by Fess and Warren (fourteenth edition).

Much has been said of McKinsey's contributions to management consulting, most of it aptly summarized in *Management and Consulting,* by William B. Wolf. McKinsey severed all ties with the firm of Frazer and Torbet in 1925 in order to establish his own firm, McKinsey and Company.[24] The June, 1928 issue of *The Accounting Review* reported that McKinsey had cut back to two courses — Business Organization and Business Policies — because of his work as an organization counselor and accountant.[25] Prior to 1928, McKinsey's address had always been listed in the Association roster as the University of Chicago. The December, 1928 roster showed a change; the new address was 120 S. LaSalle Street, no longer the University.

McKinsey's consulting practice was quite successful. One of his former students recently told this author how impressed his students were with his success. It seems that McKinsey would have his chauffeur drive him to class, and carry his briefcase into the classroom. Following the class, the chauffeur would reappear, erase the blackboard, and then take his employer downtown to his office.

However, McKinsey never developed a school of thought or a group of followers. He preferred new challenges and thus made contributions in many areas without focusing on any one to the degree necessary to have his name associated with it. Wolf believes that the reason McKinsey was practically forgotten within twenty years of his death was due to McKinsey's attitude. His personality was not one to inspire love or discipleship.[26]

In 1935, McKinsey's firm was hired to conduct a study of Marshall Field & Company, following which he became chairman of the Board. He was soon able to turn Marshall Field's red ink into profit; possibly at the cost of his health. He died of pneumonia on November 30, 1937. His death went unmentioned in accounting periodicals, although obituaries did appear in some management publications.[27] The American Accounting Association at the 1937 annual meeting adopted a resolution mourning McKinsey's loss.

Conclusion

James O. McKinsey made contributions to accounting and business education in the fields of budgeting, managerial accounting, accounting principles, business policy, and managerial finance. He was fortunate to be affiliated with the School of Commerce and Administration at the University of Chicago at a time when that school was experimenting with a comprehensive approach to business education. McKinsey worked within the confines of that experiment and developed programs for both industry and education that are still in use today. He is also remembered as the former chairman of Marshall Field & Company and for the management consulting firm which still bears his name. This legacy was left by a man who died in 1937 at the relatively young age of 48.

McKinsey should be more widely recognized and appreciated for having authored the first budgeting book and the first managerial accounting textbook. Through his emphasis on principles instead of procedures, McKinsey was the first accounting author to base his writings on the uses of accounting rather than on its preparation. Indeed, McKinsey was one of those few individuals who have explored the frontiers of business research. His efforts in pushing back those frontiers have expanded the horizons for others who followed him.

FOOTNOTES

[1]Previts and Merino, p. 278.
[2]Zeff, p. 14.

[3]Zeff, p. 22.
[4]Scovill, p. 171.
[5]Yearbook, p. 96.
[6]Wolf, p. 1ff.
[7]McKinsey, 1922.
[8]Heyel.
[9]McKinsey, 1922, p. 4.
[10]Wolf, p. 18.
[11]Hopf, p. 501.
[12]McKinsey, 1922, p. 421.
[13]McKinsey, 1919, p. 763.
[14]McKinsey, 1919.
[15]McKinsey, 1919, p. 768.
[16]McKinsey, 1923, p. 81.
[17]McKinsey, 1924, p. xii.
[18]McKinsey, 1924, p. xiii.
[19]McKinsey, 1924, p. xi.
[20]McKinsey, 1919, p. 773.
[21]Vatter, 1984.
[22]Vatter, 1950.
[23]Vatter, 1950, p. v.
[24]"University Notes," 1926.
[25]"University Notes," 1928.
[26]Wolf, pp. 14-15.
[27]"A Management Engineer," p. 9.
[28]Scovill, p. 178.

REFERENCES

"A Management Engineer," *American Business* (January, 1938), p. 9.

Heyel, Carl, ed., *Encyclopedia of Management* (New York: Litton Educational Publishing, 1963).

Hopf, H. A., "Soundings in the Literature of Management," Some Classic Contributions to Professional Management: *Historical Perspectives,* Vol. 2 (General Electric Co., 1956).

McKinsey, J. O., "Accounting as an Administrative Aid," *Journal of Political Economy* (November, 1919), pp. 759-781.

————————, *Budgetary Control* (Ronald Press, 1922).

————————, "Budgetary Control: Its Meaning and Advantages," *American Fertilizer* (August 23, 1924), pp. 24-27.

————————, *Managerial Accounting* (University of Chicago Press, 1924).

————————, "Municipal Accounting," *Journal of Accountancy* (February, 1923), pp. 81-94.

————————, "Relation of Budgetary Control to Cost Accounting," *National Association of Cost Accountants Official Publications* (January 15, 1922), pp. 2-14.

Previts, Gary J. and Barbara D. Merino, *A History of Accounting in America* (New York: Ronald Press, 1979).

Scovill, H. T., "Reflections of Twenty-five Years in the American Accounting Association," *The Accounting Review* (June, 1941), pp. 167-175.

"University Notes," *The Accounting Review* (December, 1926).
"University Notes," *The Accounting Review,* (June, 1928).
Vatter, William J., Letter to the Authors, May 27, 1984.
________________, *Managerial Accounting* (Prentice-Hall, 1950).
Wolf, W. B., *Management and Consulting: An Introduction to James O. McKinsey* (New York State School of Industrial and Labor Relations, Cornell University, 1978).
Yearbook, University of Arkansas Law School, 1913.
Zeff, S. A., *The American Accounting Association: Its First Fifty Years* (American Accounting Association, 1966).