

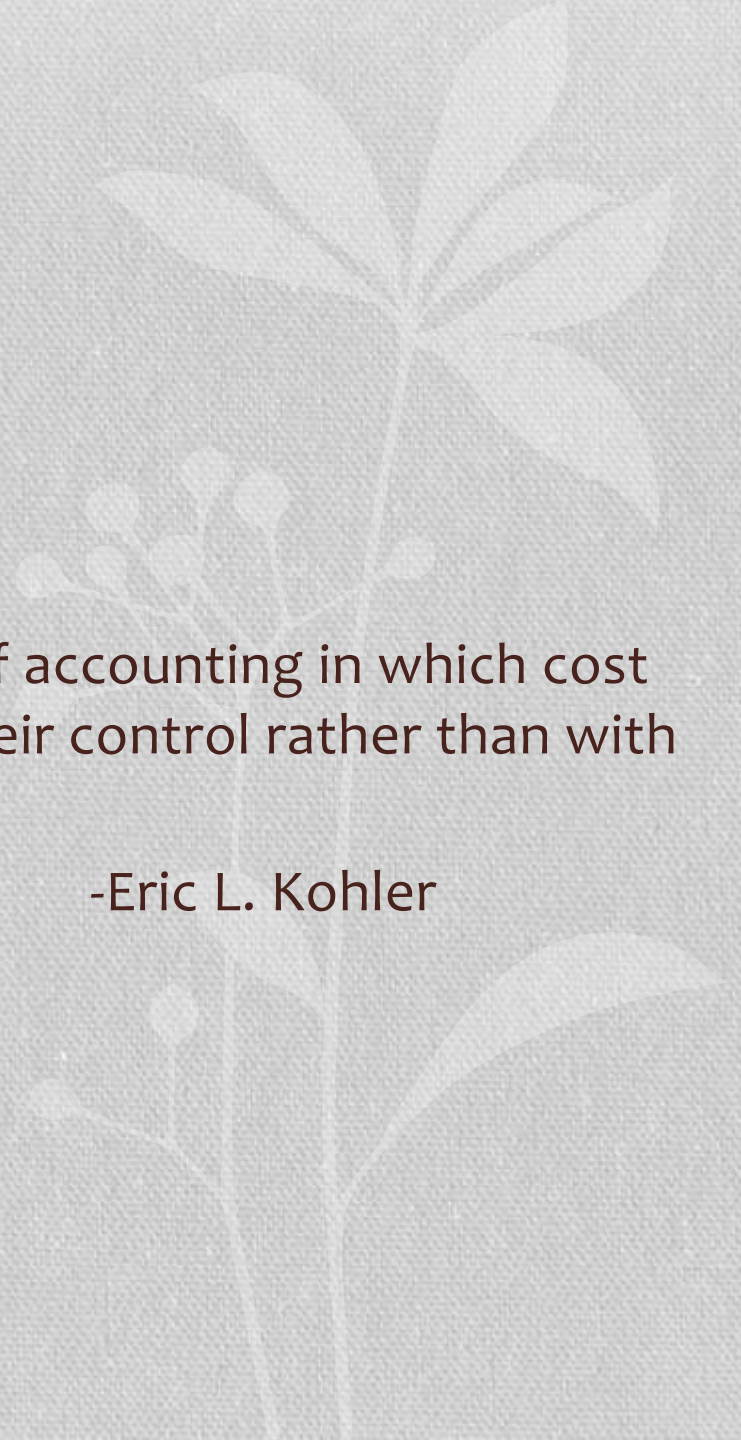
RESPONSIBILITY ACCOUNTING



Definition & Meaning

“Responsibility accounting as a method of accounting in which cost are identified with persons assigned to their control rather than with products or functions”

-Eric L. Kohler

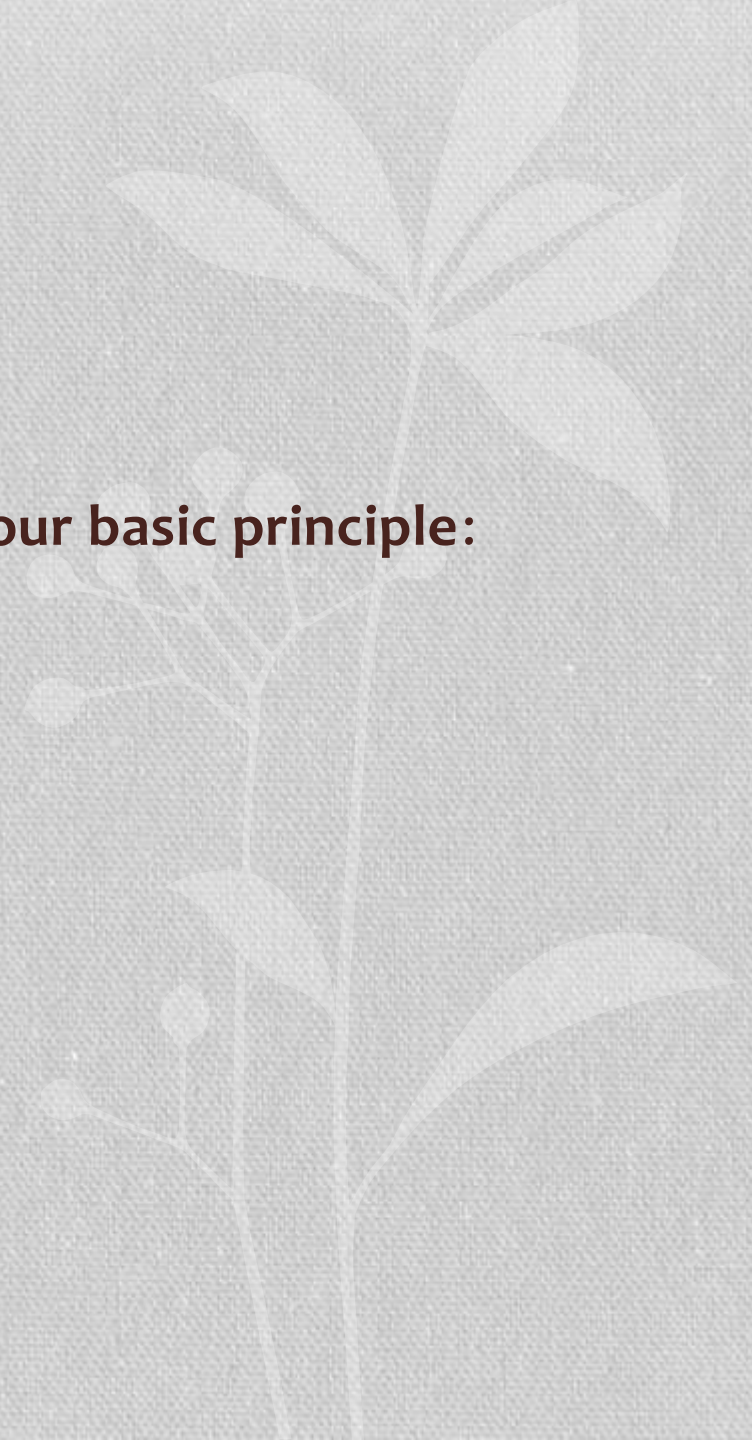


Basic Principles

- The organization structure must be clearly defined, and responsibility delegated so that each person know his role.
- The extent and limits of functional control must be determined.
- Responsible individuals must be served with regular performance reports.
- Every item should be the responsibility of some individuals within the organization.

Responsibility accounting is based on four basic principle:

- Objectives:
- Controllable cost
- Explanation
- Management by Exception



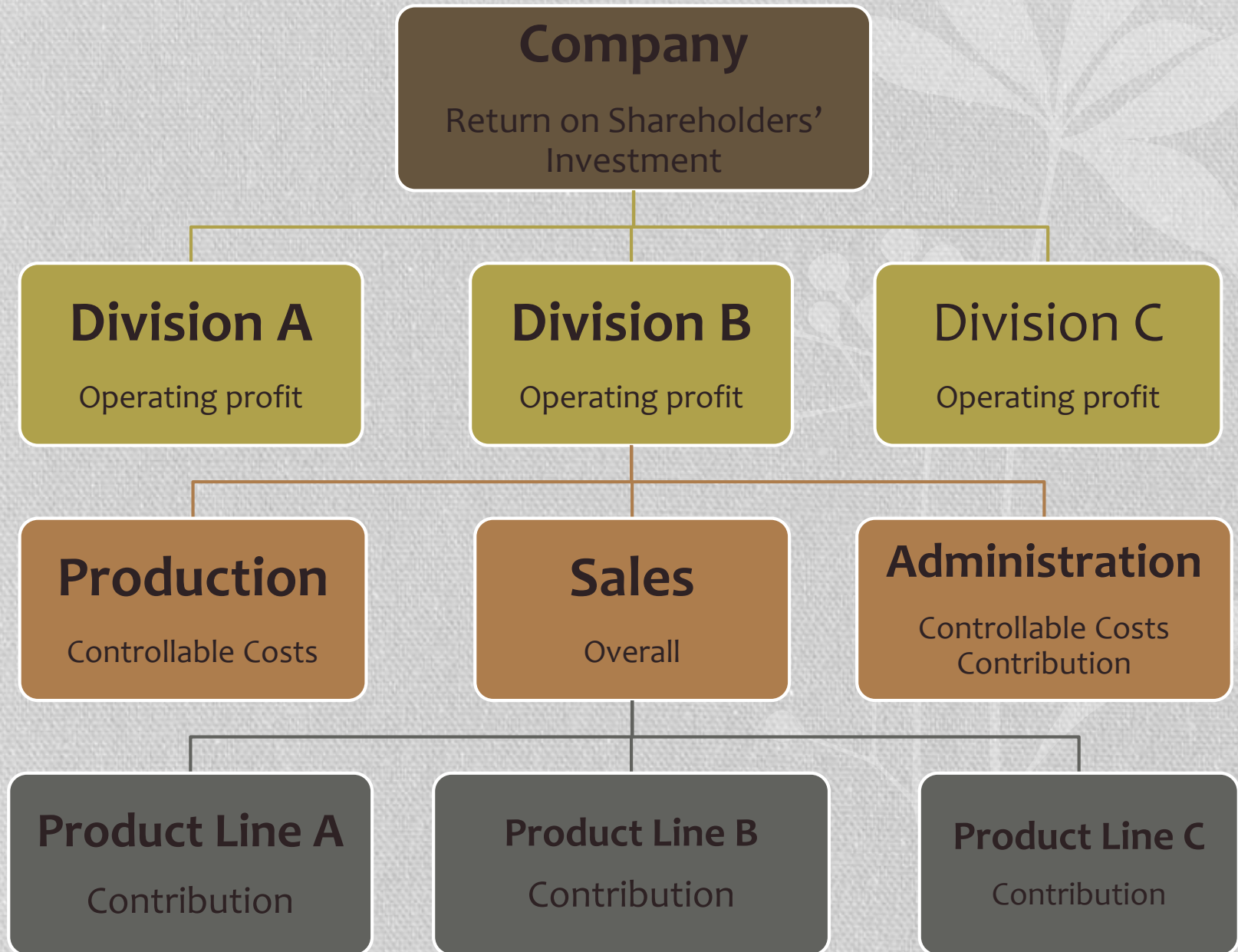
Benefits of Responsibility accounting

- It necessitates the need of clearly defining and communicating the corporate objective and individual goals.
- It compels management to set realistic plans and budgets.
- Exception reporting, built into any fully developed responsibility accounting system, enables managers to concentrate on the key issues which need their attention.
- It provides as system of closer control.

Implementation Process

- Responsibility centres within the organization are identified.
- For each responsibility centre the extent of responsibility is defined.
- Accounting system that can accumulate information by areas of responsibility is specified.
- Performance reports are prepared to provide information to those who will use them.
- Controllable and noncontrollable activities at various levels of responsibility are specified.

Organizational Assignment of Responsibilities



Responsibility Reporting

Meaning of Responsibilities Reporting

Responsibility reporting is an accounting and management reporting system directed towards controlling costs according to responsibility centers.

It involves in defining and grouping of responsibilities within an organization structure, determination and assignment of cost to appropriate levels of activities and strong emphasis and controllability.

Profoma Responsibility Reporting

A specimen responsibility report is given below:

Responsibility Report

Department:	Month:				
Foreman:					
Production (in units)		Budgeted	Actual	Variance (adverse/ favourable)	Remarks
Controllable Costs:					
Direct material		XXX	XXX	XX	
Direct labour		XXX	XXX	XX	
Indirect material		XXX	XXX	XX	
Maintenance		XXX	XXX	XX	
Indirect labour		XXX	XXX	XX	
	(a)	XXX	XXX	XXX	
Noncontrollable Costs:					
Depreciation		XXX	XXX	XX	
Building maintenance		XXX	XXX	XX	
Other allocated cost		XXX	XXX	XX	
	(b)	XXX	XXX	XX	
Total Cost	(a) + (b)	XXX	XXX	XXX	

Important Consideration in Preparation of Responsibility Report

- The report should include costs incurred for a particular responsibility centre.
- Distinguished into controllable cost and noncontrollable costs depending upon the controllability relating to the concerned responsibility.
- Common or joint costs pertaining to various responsibility centres should be allocated to RC.
- Variance should be highlighted between costs incurred and budgeted cost for purpose of comparison & to take remedial measure for adverse variance.

Centres of control in Responsibility Accounting

Based on cost allocation and profit measurement, managerial units are classified into the following:

- 1) Cost Centre
- 2) Revenue Centre
- 3) Profit Centre
- 4) Investment Centre

Cost Centre

Cost centre is a location, function or items of equipment in respect of which costs may be ascertained and related to cost units of control purpose.

Is defined in CIMA's official terminology *as "a production or service, function, activity or item of equipment whose costs may be attributed to cost units."*

From functional point of view, a cost centre may be of any of the following:

1. Production cost centre
2. Service cost centre
3. Manufacturing Centre

Revenue Centre

- Revenue centre is a centre devoted to raising revenue with no responsibility for production, e.g., a sales centre.
- It is a responsibility centre in which a manager is only held responsible for the level of revenue or outputs of a centre, as measured in monetary terms, but not responsible for the cost of the goods or service that the centre sells.

Responsibility Centre (RC)

- RC is a unit or function of an organization headed by a manager having direct responsibility for its performance.
- RC is a personalized group of cost centre under the control of a responsible individual.
- Under RC approach, the accounting system generates information on the basis of managerial responsibility, allowing that information to be used directly in motivating and controlling each manager's actions incharge of RC.

Profit Centre

- A profit centre is any subunit of an organization to which both revenues and costs are assigned, so that the profitability of the subunit may be measured.
- Necessary to have units of the organization to which both revenues and costs can be separately attributed.
- Managers of profit centre should also responsible for revenue as well as costs, which implies that there should be sufficient decentralization of authority within the company to permit profit centre, managers to make decisions about selling prices and output levels at those prices.

Advantages

1. Motivates managers to perform well in areas they control.
2. Encourages initiative.
3. Uses divisional managers' specialized market knowledge.
4. Gives local managers responsibility for making trade offs.
5. Helps in training future managers.

Disadvantages

1. Confuses division's results with manager's performance.
2. Overemphasizes on short term results.
3. Risk, mistakes by divisional managers which top management might avoid.
4. Hard to arrange for goal congruence.
5. Complicated by transfer price problem.

Investment Centre

- Where a divisional manager of a company is allowed some discretion about the amount of investment undertaken by the division, assessment of results by profit alone is clearly inadequate.
- The profit earned must be related to the amount of capital invested. Such divisions are sometimes called “investment centre”.
- For this reason performance is measured by Return on capital employed (ROCE), often referred to as Return on investment (ROI) and for other subsidiary ratios, or by Residual income (RI)
- Formulae are:
 - = Sales / Invested capital * Net income / sales
 - = Net income / Invested capital
 - = capital turnover * Percentage margin on sales = ROI

Cost Center



The human resources department is an example of a cost center.

Profit Center



An individual fast-food restaurant in a large chain is an example of a profit center.

Investment Center



A theme park is an example of an investment center.

Responsibility accounting encompasses the following steps:

1. Identifying The Responsibility Centers
2. Delegation Of Authority And Responsibility Or Decentralization
3. Controllable Of The Object
4. Establishing Performance Evaluation Criteria
5. Electing Cost Allocation Bases

THE MAIN ROLES OR CONTRIBUTION OF RESPONSIBILITY ACCOUNTING

- **Decentralization**

The organization becomes more manageable

- **Performance Evaluation**

The performance is measured and presented periodically on performance report

- **Motivation**

job becomes more challenging for the employees and motivates them to use their full potentiality

- **Transfer Pricing**

product or service of one division or unit can be transferred to another division or unit within the same organization

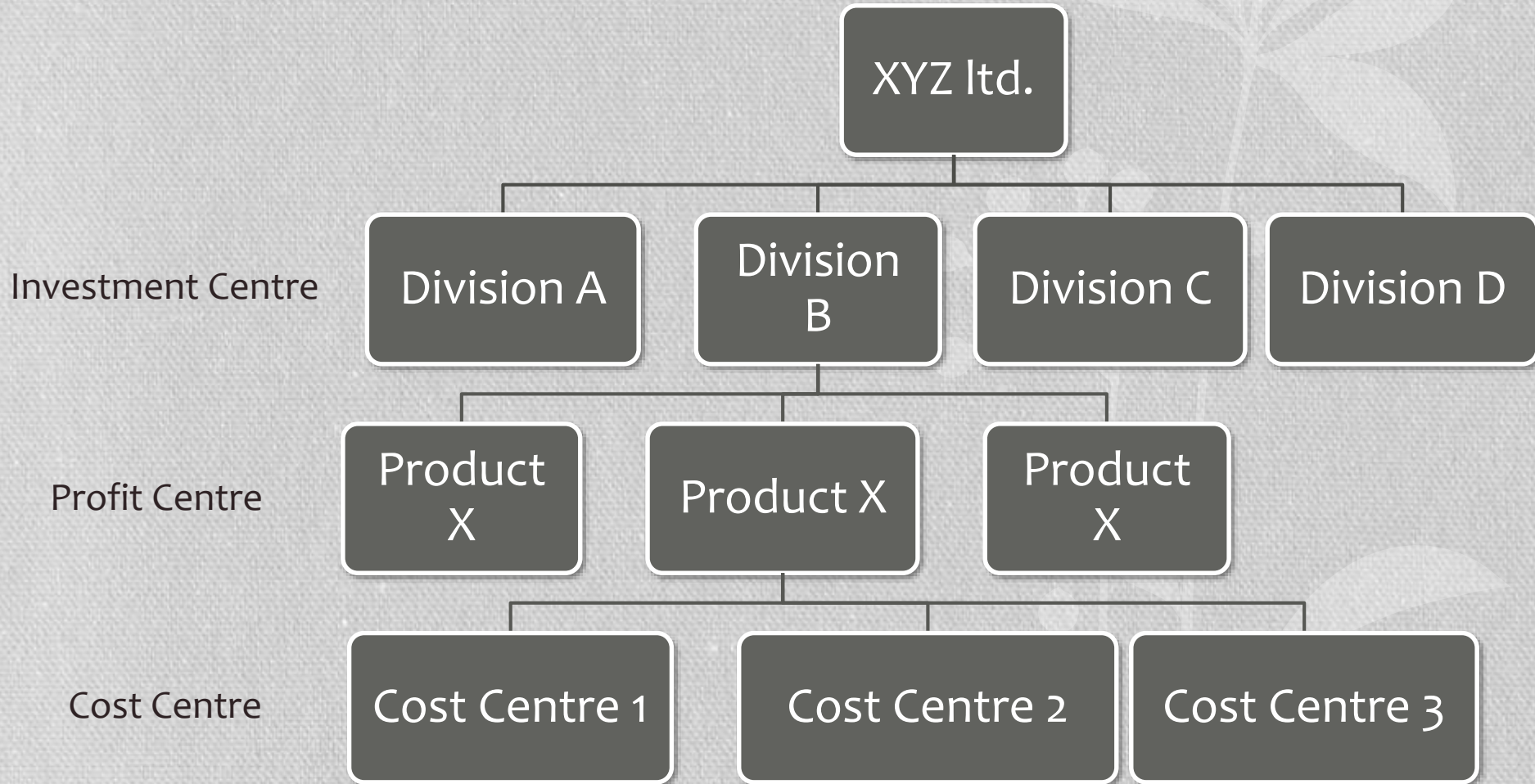
- **Drop Or Continue Decision**

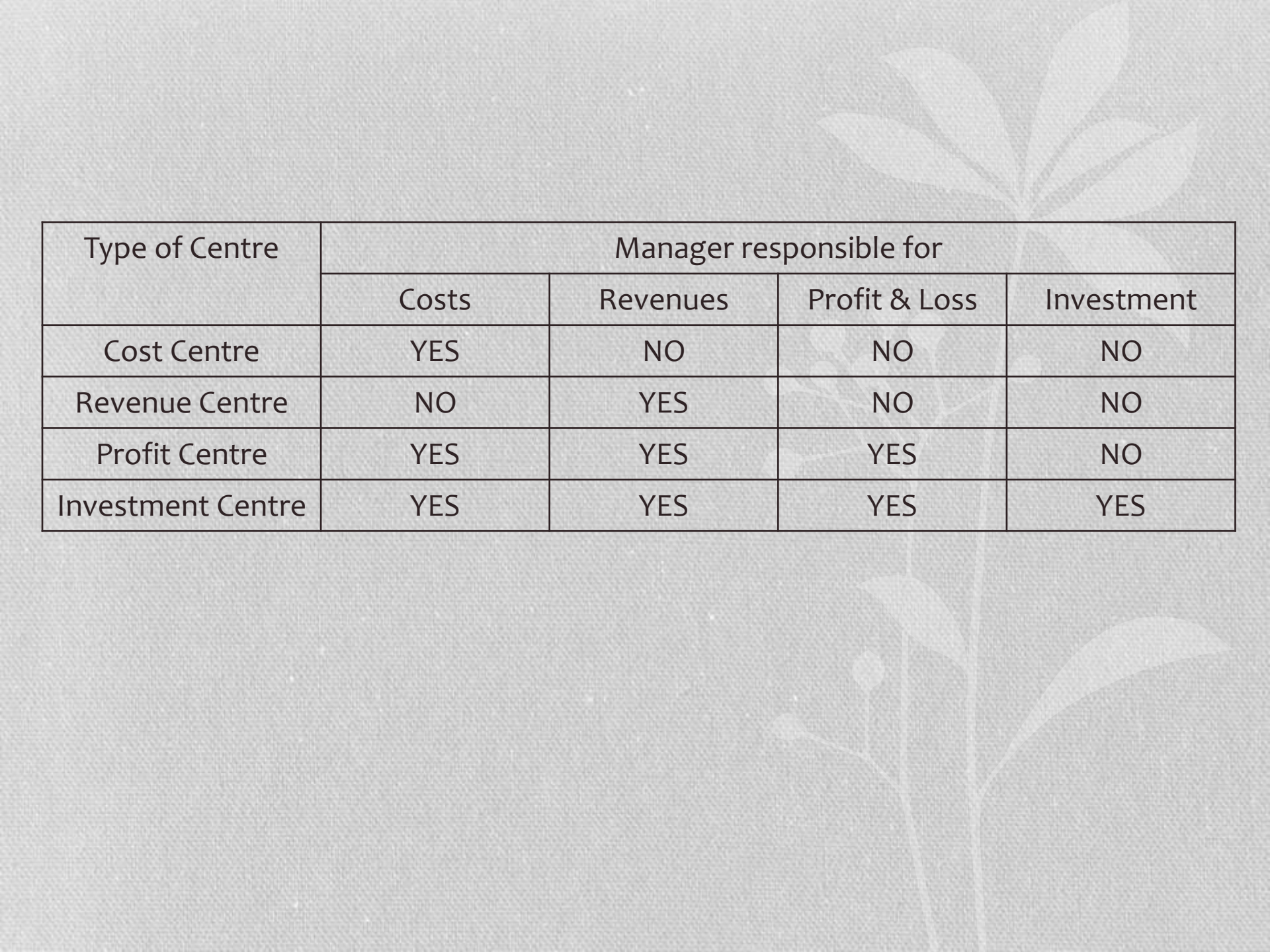
saving in costs exceeds the foregone revenues, the center can be discontinued

Extent of Manager's Control in Cost, Profit and Investment Centre

Types of responsibility centre	Manager has control over	Principal Performance Measurement
Cost Centre	-Cost(Only controllable cost item)	-Variance analysis -Efficiency analysis
Profit Centre	-Cost(Controllable costs) -Sale prices(including transfer prices) -Output volumes	-Profit
Investment Centre	-Cost(Controllable costs) -Sale prices(including transfer prices) -Output volumes -Investment in fixed and current assets	-Return on investment -Residual income Other financial ratios

Represent the relationship of cost, profit and investment centres in an organization





Type of Centre	Manager responsible for			
	Costs	Revenues	Profit & Loss	Investment
Cost Centre	YES	NO	NO	NO
Revenue Centre	NO	YES	NO	NO
Profit Centre	YES	YES	YES	NO
Investment Centre	YES	YES	YES	YES

Thank You