

RESPONSIBILITY ACCOUNTING
Chapter 12

I. CHARACTERISTICS OF RESPONSIBILITY ACCOUNTING

A. Definition.

- an accounting system that collects, summarizes, and reports accounting data relating to the responsibilities of individual managers.
- an accounting system which tracks and reports costs, expenses, revenues, and operational statistics by area of responsibility or organizational unit.
- the system provides information to evaluate each manager on revenue and expense items over which that manager has primary control (authority to influence).
- some reports contain only those items that are controllable by the responsibility manager.
- some reports contain both controllable and uncontrollable items;
 - in this case, controllable and uncontrollable items should be clearly separated.
- the identification of controllable items is a fundamental task in responsibility accounting and reporting.

B. Some Basic Requirements.

- to implement a responsibility accounting system, the business must be organized so that responsibility is assignable to individual managers.
- the various managers and their lines of responsibility should be fully defined.
- the organization chart is usually used as a basis for responsibility reporting.
- if clear lines of responsibility cannot be determined, it is very doubtful that responsibility accounting can be implemented effectively.
- while decision-making power may be delegated for many items, some decisions (related to particular revenues, expenses, costs or actions) may remain exclusively under the control of top management.

- several items will be directly traceable to a particular manager's area of responsibility but not actually be controllable by that manager. (Items such as property taxes.)

- Note: the controllability criterion is crucial to the content of performance reports for each manager.

II. THE CONCEPT OF CONTROL.

A. Absolute Control.

- theoretically, a manager should have absolute control over an item to be held responsible for it.

- absolute controllability is rare.

- frequently, external or internal factors beyond a manager's control may affect revenues or expenses under that manager's responsibility.

- the theoretical requirement regarding absolute control must often be compromised, since some degree of noncontrollability usually exists.

- the manager is therefore usually held responsible for items over which that manager has relative control.

B. Relative Control.

- relative control means that the manager has control over most of the factors that influence a given budget item.

- the use of relative control as a basis for evaluation may lead to some motivational problems, since managers may be evaluated on results that may not reflect the manager's efforts or decisions.

- most budget plans assign control on a relative basis in order to develop and use segmental budgets.

III. RESPONSIBILITY REPORTS.

A. Basic Features.

- a feature of a responsibility accounting system is the varying amount of detail included in the reports issued to different levels of management.

- although the amount of detail varies, reports issued under a responsibility accounting system are interrelated.

- totals from the report on one level of management are carried forward in the report to the management level immediately above.

- data is appropriately summarized, filtered, and/or condensed as information flows upward to higher levels of management.
- encourages or allows "management by exception."
- two basic methods are applied to present revenue and expense data:
 - (1) only those items over which a manager has direct control are included in the responsibility report for that management level.
 - any revenue or expense that the manager cannot directly control are not included.
 - (2) include all revenue and expense items that can be traced directly or allocated indirectly to a particular manager, whether or not they are controllable.
 - in this approach, care must taken to separate controllable from noncontrollable items in order to differentiate those items for which a manager can and should be held responsible.

B. Desired Features.

1. Timely
2. Issued Regularly
3. Format should be relatively simple and easy to read.
 - confusing terminology should be avoided.
 - results should be expressed in physical terms where appropriate, since such figures may be more familiar and understandable to managers.
 - to assist management in quickly spotting budget variances, both budgeted and actual amounts should be reported.
 - a budget variance is the difference between the budgeted and actual amounts of an item.
 - because variances highlight areas which require investigation, they are helpful in applying the management by exception principle.
 - reports often include both current and year-to-date analyses.

IV. RESPONSIBILITY REPORTS – SEE TEXT FOR AN ILLUSTRATION.

V. RESPONSIBILITY CENTERS.

A. Basic Concepts.

1. A Segment.

- is a fairly autonomous unit or division of a company defined according to function or product line.
 - function: marketing, production, finance, etc.
 - product line: shoe department, electrical products, food division.

2. A Responsibility Center.

- is a segment of an organization for which a particular executive is responsible.
- there are three types of responsibility centers:
 - (1) expense (or cost) center.
 - (2) profit center.
 - (3) investment center.

B. Expense (Cost) Centers.

- a responsibility center incurring only expense (cost) items and producing no direct revenue from the sale of goods or services.
- managers are held responsible only for specified expense items.
- the appropriate goal of an expense center is the long-run minimization of expenses.
- short-run minimization of expenses may not be appropriate.

C. Revenue Centers

- managers are held responsible for revenues (sales) only.
- managers of such centers also responsible for controlling expenses of unit as well.

D. Profit Centers.

- a responsibility center having both revenues and expenses.
- the manager must be able to control both of these categories.

- controllable profits of a segment are shown when expenses under a manager's control are deducted from revenues under that manager's control.
- an expense center can be converted into a profit center by the utilization of transfer prices.
 - i.e., via the use of transfer prices, "artificial revenues" can be generated for an expense center as it charges other organizational units of the company for its services or product.

E. Investment Centers.

1. Basic Characteristics.

- a responsibility center having revenues, expenses, and an appropriate investment base.
- the manager in charge of an investment center is responsible for and has sizable control over revenues, expenses, and the investment base.
- the two most common ways for evaluating the performance of such a center are :
 - (1) ROI (return on investment.)
 - (2) Residual Income.

2. Determining the Investment Base to be used in ROI calculations.

- it is a tricky matter.
- two key issues which must be resolved in determining the value of the investment base are
 - (1) which assets should be included, and
 - key question: are the included assets actual controlled by the division managers?
 - (2) how those assets should be valued.
 - Major alternative:
 - Original Cost.
 - Book Value (original cost less accumulated depreciation to date.)
 - Replacement Cost.

- Note: which ever choices are applied, managers will be motivated in some direction.

- companies prefer to evaluate segments as investment centers because the ROI criterion facilitates performance comparisons between segments.