

# RESPONSIBILITY ACCOUNTING

Responsibility accounting is a management control system based on the principles of delegating and locating responsibility. The authority is delegated on responsibility centre and accounting for the responsibility centre. Responsibility accounting is a system under which managers are given decisions making authority and responsibility for each activity occurring within a specific area of the company. Under this system, managers are made responsible for the activities of segments. These segments may be called departments, branches or divisions etc., one of the uses of management accounting is managerial control. Among the control techniques “responsibility accounting” has assumed considerable significance. While the other control devices are applicable to the organization as a whole, responsibility accounting represents a method of measuring the performance of various divisions of an organization. The term ‘division’ with reference to responsibility accounting is used in general sense to include any logical segment, component, sub-component of an organization. Defined in this way, it includes a department, a branch office, a service centre, a product line, a channel of distribution, for the operating performance it is separately identifiable and measurable is some what of practical significance to management.

Robert Anthony defines responsibility accounting as that type of management accounting which collects and reports both planned and actual accounting information in terms of responsibility centers.

According to Charles T. Horngren, Responsibility Accounting or profitability accounting or activity accounting which means the same thing, is a system that recognizes various decision or responsibility centers throughout the organization and traces costs (and revenue, assets and liabilities) to the individual managers who are primarily responsible for making decisions about the costs in question.

## Significance of Responsibility Accounting

The significance of responsibility accounting for management can be explained in the following way:

### Easy Identification:

It enables the identification of individual managers responsible for satisfactory or unsatisfactory performance.

### Motivational Benefits :

If a system of responsibility accounting is implemented, considerable motivational benefits are assured.

### Data Availability :

A mechanism for presenting performance data is provided. A framework of managerial performance appraisal system can be established on that basis, besides motivating managers to act in the best interests of the enterprise.

**Ready-hand Information:**

Relevant and up to the minutes information is made available which can be used to estimate future costs and or revenues and to fix up standards for departmental budgets.

**Planning and Decision Making:**

Responsibility accounting helps not only in control but in planning and decision making too.

**Delegation and Control:**

The twin objectives of management are delegating responsibility while retaining control are achieved by adoption of responsibility accounting system.

**Principles of responsibility Accounting**

The main features of responsibility accounting are that it collects and reports planned and actual accounting information about the inputs and outputs of responsibility accounting.

**Inputs and outputs :**

Responsibility accounting is based on information relating to inputs and outputs. The resources used are called inputs. The resources used by an organization are essentially physical in nature such as quantity of materials consumed, hours of labour, and so on. For managerial control, these heterogeneous physical resources are expressed in monetary terms they are called cost. Thus, inputs are expressed as cost. Similarly, outputs are measured in monetary terms as “revenues”. In other words, responsibility accounting is based on cost and revenue data or financial information

**Objectives of Responsibility Accounting :**

Responsibility accounting is a method of dividing the organizational structure into various responsibility centers to measure their performance. In other words responsibility accounting is a device to measure divisional performance measurement may be stated as under:

1. To determine the contribution that a division as a sub-unit makes to the total organization.
2. To provide a basis for evaluating the quality of the divisional managers performance. Responsibility accounting is used to measure the performance of managers and it therefore, influence the way the managers behave.
3. To motivate the divisional manager to operate his division in a manner consistent with the basic goals of the organization as a whole.

**Responsibility Centre :**

**For control purposes, responsibility centers are generally categorized into:**

1. Cost centres
2. Profit centers
3. Investment centers.

**1. Cost Centre or Expense Centre:**

An expense centre is a responsibility centre in which inputs, but not outputs, are measured in monetary terms. Responsibility accounting is based on financial information relating to inputs

(costs) and outputs (revenues). In an expense centre of responsibility, the accounting system records only the cost incurred by the centre but the revenues earned (outputs) are excluded. An expense centre measures financial performance in terms of cost incurred by it. In other words, the performance measured in an expense centre is efficiency of operation in that centre in terms of the quantity of inputs used in producing some given output. The modus operandi is to compare actual inputs to some predetermined level that represents efficient utilization. The variance between the actual and budget standard would be indicative of the efficiency of the division.

## **2. Profit Centre:**

A centre in which both the inputs and outputs are measured in monetary terms is called a profit centre. In other words both costs and revenues of the centre are accounted for. Since the difference of revenues and costs is termed as profit, this centre is called profit centre. In a centre, there are financial measures of the outputs as well as of the input, it is possible to measure the effectiveness and efficiency of performance in financial terms. Profit analysis can be used as a basis for evaluating the performance of divisional manager. A profit centre as well as additional data regarding revenues. Therefore, management can determine whether the division was effective in attaining its objectives. This objective is presumably to earn a “satisfactory profit”. Profit directly traceable to the division and voidable if the division were closed down. The concept of divisional profit is referred to as ‘profit contribution’ as it is amount of profit contribution directly by the division.

The performance of the managers is measured by profit. In other words managers can be expected to behave as if they were running their own business. For this reason, the profit centre is good training for general management responsibility .

### **Measurement of Expenses :**

Another problem with profit centers may relate to the measure of certain type of expenses which have to be involved in the computation of profit centres. There is a scope for difference of opinion relating to the treatment of those type of expenses which are not traceable or attributable should be ignored in working out the profit of the division as a profit centre.

### **Transfer of Prices :**

A transfer price is a price used to measure the value of goods and services furnished by a profit centre to other responsibility centers within a company. In other words, when internal exchange of goods and services takes place between the different divisions of a firm, they have to be expressed in monetary terms. The monetary amount for these interdivisional exchange transfers is called the transfer prices. The measurement of profit in a profit centre type or responsibility accounting is also complicated by the problem of transfer prices. The implication of the transfer price is that for the selling division it will be a source of revenue, where as for the buying division (the division which is receiving, acquiring the goods and services) it is an element of cost. It will therefore, have a significant bearing on the revenues, costs therefore, have a significant bearing on the revenues, costs and profits of responsibility centres. Hence, there is a need for correct determination of transfer prices. The determination is, however, complicated because of wide variety of alternative methods are available. They are explained as under :

### **Types of Transfer Price :**

There are two general approaches to the determination of a transfer price :

#### **1. Cost based and**

2. Market based, Based on these, there are five basic methods of transfer price :

- a) Cost
- b) Cost plus a normal mark-up
- c) Incremental cost
- d) Market price, and
- e) Negotiated price

### 3. Investment Centers

A centre in which assets employed are also measured besides the measurement of inputs and outputs is called an investment centre. Inputs are accounted for in terms of costs, outputs are calculated on investment centre. Inputs are accounted for in terms of costs, outputs are accounted for in terms of revenues and assets employed in terms of values. It is the broadest measurement, in the sense that the performance is measured not only in terms of profits but also in terms of assets employed to generate profits.

An investment centre differs from a profit centre in that as investment centre is evaluated on the basis of the rate of return earned on the assets invested in the segment while a profit centre is evaluated on the basis of excess revenue over expenses for the period.

#### **Controllability :**

As is evident from the above description, the notion controllability is prime in a system of responsibility accounting. A responsibility centre is accountable for controllable factors only. It is but natural also, since how can one be held responsible for factors beyond one's control. Therefore, it is essential to identify which costs are controllable and which costs are not controllable.

A cost is treated as controllable only when the person responsible for incurring it can exercise his influence over it. Costs which cannot be so influenced are termed as uncontrollable costs.

### **Problems in Responsibility Accounting**

While implementing the system of responsibility accounting, the following difficulties are likely to be faced by the management:

- 1. Classification of costs:** For responsibility accounting system to be effective a proper classification between controllable and non controllable costs is a prime requisite. But practical difficulties arise while doing so on account of the complex nature and variety of costs.
- 2. Inter-departmental Conflicts:** Separate departmental pursuits may lead to inter-departmental rivalry and it may be prejudicial to the interest of the enterprise as a whole. Managers may act in the best interests of their own, but not in the best interests of the enterprise.
- 3. Delay in Reporting:** Responsibility reports may be delayed. Each responsibility centre can take its own time in preparing reports.
- 4. Overloading of Information:** Responsibility accounting reports may be overloading with all available information. This danger is inherent in the system but with clear instructions by management as to the functioning of the system and preparation of reports, etc., only relevant information flow in.
- 5. Complete Reliance will be deceptive:** Responsibility accounting can't be relied upon completely as a tool of management control. It is a system just to direct the attention of management to those areas of performance which required further investigation.