RESPONSIBILITY ACCOUNTING

Syllabus
Module V
Responsibility Accounting –Concept – Significance – Responsibility centers-
Activity Based Costing – (General outline only)-05 Hours

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.
-A system of accountability in which managers are held responsible for those items of revenue and cost - and only those items - over which the manager can exert significant control.

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.)

RESPONSIBILITY CENTERS.

Basic Concepts.
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.
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.**

- 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.

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, consider-able 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.

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 persuits 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.

Activity-based costing (**ABC**)

Activity-based costing (ABC) is a special costing model that identifies activities in an organization and assigns the cost of each activity with resources to all products and services according to the actual consumption by each. This model assigns more indirect costs (overhead) into direct costs compared to conventional costing models.

- identify and eliminate those products and services that are unprofitable and lower the prices of those that are overpriced (product and service portfolio aim)
- or identify and eliminate production or service processes that are ineffective and allocate processing concepts that lead to the very same product at a better yield (process re-engineering aim).

In a business organization, the ABC methodology assigns an organization's resource costs through activities to the products and services provided to its customers. ABC is generally used as a tool for understanding product and customer cost and profitability based on the production or performing processes. As such, ABC has predominantly been used to support strategic decisions such as pricing, outsourcing, identification and measurement of process improvement initiatives

ABC is an alternative to traditional accounting in which a business's overheads (indirect costs such as lighting, heating and marketing) are allocated in proportion to an activity's direct costs. This is unsatisfactory because two activities that absorb the same direct costs can use very different amounts of overhead. A mass-produced industrial robot, for instance, can use the same amount of labour and materials as a customised robot. But the customised robot uses far more of the company engineers' time (an overhead) than does the mass-produced one.

This difference would not be reflected in traditional costing systems. Hence a company that makes more and more customised products (and bases its pricing on historic costings) can soon find itself making large losses. As new technologies make it easier for firms to customise products, the importance of allocating indirect costs accurately increases.

Introducing activity-based costing is not a simple task—it is by no means as easy as ABC. For a start, all business activities must be broken down into their discrete components. As part of its ABC programme, for example, ABB, a Swiss-Swedish power company, divided its purchasing activity into things like negotiating with suppliers, updating the database, issuing purchase orders and handling com-plaints.

Activity-based costing became popular in the early 1980s largely because of growing dissatisfaction with traditional ways of allocating costs. After a strong start, however, it fell into a period of disrepute. Even Robert Kapla, a Harvard Business School professor sometimes credited with being its founding father, has admitted that it stagnated in the 1990s. The difficulty lay in translating the theory into action. Many companies were not prepared to give up their traditional cost-control mechanisms in favour of ABC.