Unit – 5

Module – 9

Responsibility Accounting
Contents

- Meaning & Definitions
- Requirements of responsibility accounting
- Benefits
- Limitations
- Responsibility centres
- Transfer Pricing
- Return on Investment
Meaning & definitions
Defining Responsibility Accounting

• Responsibility accounting is an arrangement under which managers are given decision making authority and are made responsible for their area of assigned activity occurring within a specific department/division of the company.

• “Responsibility accounting is a system of accounting that recognizes various responsibility centres throughout the organization and reflects the plans and actions of each of these centres by assigning particular revenues and cost to the one having the pertinent responsibility. It is also called profitability accounting and activity accounting.”

• Charles T Horngren
“Responsibility accounting as that type of management accounting that collects and reports both planned and actual accounting information in terms of responsibility centre”.

Robert N Antony

“A method of accounting in which costs are identified with persons assigned to their control rather than with producers or functions”.

Eric I Kohler
Requirements of Responsibility

Accounting
Requirement of responsibility accounting

- A sound and well designed organization structure with strictly defined authority and responsibility should exist.
- The organization should be divided into various defined responsibility centres.
- Development of accurate and effective budgets keeping in mind the opinions the concerned managers and requirements as well.
- The responsibility accounting system so adopted ought to have full support from the higher authorities of the organization.
Continue…

- The system so designed and implemented should be understood be the managers fully and thus should provide support as well for its effective operation.
- A conducive organizational environment and progressive management attitude should exist.
Benefits of Responsibility Accounting
Benefits

- Clarity of goals
- Assists in setting realistic plans and budgets
- Improves quality
- Cost control
- Objective evaluation
- Decentralization decision making
Limitations of Responsibility

Accounting
Limitations...

- Failure of support of top management
- Unorganized structure of the organization
- Unrealistic goals
- Defective reporting system
- Impact of behavioural system
Responsibility Centres
Responsibility Centres

- A responsibility centre is a subunit of an organization under the control of a manager.
- A small firm can possibly be managed by an individual in the past but in today’s era, a large firm is necessarily divided into appropriate segments or departments for ensuring efficient managerial control.
- The main criterion in the creation of this centre is that the subunit of the organization should be separable and identifiable for operating performance.
Cost Centre

- Cost centre is a smaller segment of activities of responsibility for which cost can be accumulated.
- In other words, the manager is held accountable only for costs incurred in their respective responsibility centre.
- A distinctive feature of this centre is that the inputs and not the outputs are measured in terms of money.
- The performance of the manager is evaluated by comparing the cost incurred with the budgeted costs.
- The management focuses on the cost variances for ensuring proper control.
Revenue Centre

- The Revenue centre is the small segment in which the manager or any person, to whom the duty is assigned, is responsible for generation of revenues.
- The CIMA defines revenue centre as a centre devoted to raising revenue with no responsibility for production.
- A distinctive feature of this centre is that the outputs and not the inputs are measured in terms of money.
- The manager here has no control over the investments in assets or the cost of manufacturing a product but might exercise the control over distribution expenses.
Profit Centre

- A profit centre is that segment of the organization which is concerned with both revenues as well as costs.
- The main aim of profit centre is to maximize the profits by either controlling costs or increasing revenues.
- CIMA defines profit centre as a part of business accountable for costs & revenues.
Investment Centre

- CIMA defines investment centre as a profit centre whose performance is measured in its return on capital employed.
- A Responsibility centre is called an investment centre, when its manager is responsible for costs and revenue as well as for the investment in assets used by his centre.
- The return on investment (ROI) is used as the performance evaluation criterion in an investment centre.
Transfer Pricing

• A transfer price is a national value at which goods and services are transferred, between divisions in a decentralized organizations.

• Transfer prices are normally set for intermediate products.

• The value of such internal transfers is expressed in terms of money and thus it becomes a transfer price.

• The main principle is that the transfer price forms revenue for selling division and an element of cost for buying division.
Objectives

- It helps in the accurate measurement of divisional profitability.
- It should motivate the divisional managers to maximize the profitability.
- It assists in making decisions that are in the best interest of the organization.
- It ensures that divisional autonomy and authority is preserved.
- It allows goal congruence to exist which in turn helps the managers to make themselves compatible to achieve the overall objective.
- A proper establishment of transfer pricing system reduces the chances of manipulations.
Methods

- Market based pricing
- Cost based pricing
- Negotiated pricing
- Dual pricing
- Incremental cost pricing