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Responsibility Centers and Performance Measurement: A Critical Analysis.

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Abstracts:

The most important element of every organization is "people" as they can easily influence the other elements (technology,goals,tasks etc). Every organization is a social system or social unit. A system may be defined as an entity consisting of a number of interrelated and interdependent components of parts which are generally known as subsystem. One of the important features of organization is that it is always engaged in goal directed activities. Like other organization business organization are also engaged in goal directed activities.
In every organization there are a number of managers in various levels of management. They perform jointly to fulfill their organizational objectives. Every manager has particularly responsibilities. They worked under the supervision of top management to fulfill their individual responsibilities. The overall success of the organization largely depends upon the fulfillment of the responsibilities of the managers.

From this viewpoint,the concept of "Responsibility Accounting"is emerged. It means a system which makes every-one conscious and responsible for the job that is entrusted to him by his supervisor. That is a control by delegating and locating responsibility for costs. Responsibility Accounting focuses on Responsibility Centres. In this article an attempt has been made to discuss all the significant areas of "Responsibility Centre" in an analytical view for a better understanding of this important managerial tool to improve the overall performance of the organisation.
Key Wards: Responsibility Centre, Profit Centre, Investment Centre, Cost Centre, Organisation Structure, Revenue Centre.

Introduction:

As a goal oriented system, business organizations always try to fulfill their goal. In order to fulfill the goal business organization needs a structure. Structure is a mean to accomplish the goal. Structure is a frame work within which different components (peoples, goals,tasks) interact with each other for the accomplishment of the organizational goals.

There are a number of people in every business organization. They perform jointly in a systematic and predetermined way to fulfill objectives of their organization. But, according to McGregor's"Theory X" peoples are basically lease, they dislike their works. They will avoid their responsibilities if it is possible. So, the controller of the business enterprise has to direct the various employees in a proper and systematic manner. From this viewpoint the concept of Responsibility accounting developed means a system which makes everyone conscious and responsible for the job entrusted to him by his supervisor.

Objectives:

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The objectives of the study are to explain the various Responsibility Centres of the organizations in the light of “Organisation Strucrure” and to examine the effectiveness of the System to improve the overall performance of the organisation in Resource Utilization, Income Generation and Employment creation.

Review of Literature:

Bettner and Whittington (1996) and Morse and Zimmerman (1997) identified different types of responsibility accounting centres such as Cost Centres, Profit centres and Investment Centres. Arya et al (1998) illustrated some subtleties related to the system They provided the suitable conditions under which responsibility accounting system works more efficiently. Ogonnu (2000) stated that organizing a business in this manner enables managers and employees to specialize in specific types of businessactivity.

Though the issue of “Responsibility Accounting” as a control device has got huge attention in last few decades, there is no doubt that most of the studies related to this issue were done in the context of developed countries of the world . Very few studies were done related to the developing countries.

Background:

In every organization there are a number of managers in various level of management. They perform jointly to fulfill their organizational objectives. Every manager has particularly responsibilities. They worked under the supervision of top management to fulfill their individual responsibilities. The overall success of the organization largely depends upon the fulfillment of the responsibilities of the managers.

From this viewpoint, the concept of “Responsibility Accounting” is emerged. It means a system which makes every-one conscious and responsible for the job that is entrusted to him by his supervisor. That is a control by delegating and locating responsibility for costs.

Responsibility Accounting is an approach to cost control whereby every item of expenditure is made the responsibility of that individual who can best influence it by his actions. It plays a significant role to control the overall managerial functions of any organizations as well as to fulfill the organizational goals. Responsibility Centers are the way to introduce Responsibility Accounting.

Responsibility centre is a personalized group of control centre under the control of an individual. Responsibility Accounting is a concept aims to help achieve a fit between planning and control system and managerial responsibilities. It is a system of accumulating and reporting both actual and budgeted costs and revenues by individual responsible for them. In Responsibility Accounting concept persons are made responsible for the execution of plans and the evolution of actual performance for determining whether actual operations have gone according to what was planned and if the actual are not according to plan, what is the extent of deviation, what is the reason for deviation. What action can be taken to bring in the future actions more in line with the plan?

So, it is quite clear that application of Responsibility Accounting system is very significant to exercise control over a firms operation so that its objectives are achieved. The line of responsibility starts with operating Superintendent, department heads and the Works Manager to the Chairman. These are levels of responsibility. The flow of information’s upward from the lowest to the highest level in each responsibility centre.

Responsibility Accounting focuses on Responsibility Centers. A Responsibility centre is a sub unit of an organization under the control of a manager who is responsible for the activities of that responsibility centre. A small firm can possible be managed by an individual or a small group of individuals, however, for effective control a large firm is divided into meaningful segments or departments. Each submit has certain activities to perform and its manager is assigned the responsibility authority to carry out those actives. These sub units of an enterprise for the purpose of control are called Responsibility centers. The important

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criterion for creating a Responsibility centre is that the unit of the organization should be separable and identifiable for operating purpose and its performance measurement should be possible.
In Responsibility Accounting system, Responsibility Centers form the decentralized unit of organization. Each Responsibility centre has a defined executive head to control operations. The other features are:

- Defined Authority
- Defined Responsibility
- Defined Input
- Defined Output
- Defined criteria of measuring executive performance.

For control purpose Responsibility Centers are divided into five categories. Such as:

i) Cost or Expenses Centre.
ii) Revenue Centre.
iii) Profit Centre.
iv) Investment Centre.
v) Contribution Centre.

i) Cost or Expenses Centre:

Costs centre is a location, function or items of equipment in respect of which costs may be ascertained and related to cost units for control purpose.
CIMA define cost centre as "a Production or Service, function, activity or item of equipment whose cost may be attributed to cost unit".
A cost centre is a smaller segment of activity or area of responsibility for which cost can be accumulated. Responsibility in a cost centre is measured in terms of cost. Since the Performance of a cost centre is measured in terms of cost. Since the Performance of a cost is measured by financial measure of cost only, an essential requirement is that the cost of operating the division be directly traceable to it. This means that the relevant costs are the incremental or avoidable cost of operating that division. The incremental cost would include both variable and fixed costs but would exclude costs common to several divisions and allocated among them on some arbitrary basis.
From the view Point of the measurement of Performance of the divisional manager, the implication of the cost centre is that his performance will be judged on the basis of the cost incurred in his department or division. What is done in the division (output/Revenue) will be of no consequence. The analysis of performance is restricted to the consumption of resources in the division and there is no reference to what the division has achieved as a consequence of consuming those resources.

ii) Revenue Centre:

Revenue centre is the smallest segment of activity or an area of responsibility for which only revenues are accumulated. A revenue centre is a part of that organization whose manager has the primary responsibility of generating sales revenues.
CIMA defines Revenue centre as "a centre devoted to rising revenue with no responsibility for production". In a revenue centre the manager is only held responsible for the level of Revenue or output of a centre but not responsible for the cost of goods or services that the centre sells.

III) Profit Centre:

Profit centre is a division of an organization in which financial performance is measured on the basis of profit. In this context profit may be defend as excess or revenues over expenses.

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CIMA defines, Profit centre as "a part of business accountable for cost and revenues."
The structural shape of a profit centre may be as below:
A profit centre's performance report measured in absolute terms would show profit on the bottom line. If a share of "head office" overheads is charge to the profit centre, these non controllable costs should be shown separately and kept distinct from directly attributable costs. A Profit centre's Performance report might look as shown in Exhibit IX below:

IV)Investment Centre:

Investment centre is a segment of activity or area held Responsibility for both profit and investment. Objective of investment centre is to maximize the centre's return on investment. CIMA defines investment centre as "a profit centre whose performance is measured by its return on capital employed."
The return of an investment centre can be measured by the use of either ROI (Return on Investment) or RI (Residual income).

$$\text{ROI} = \frac{Sales}{\text{Capital Invested}} \times \frac{Net\ Income}{Sales}$$

Return on Investment (ROI) depends upon two ratios:

i) Net Profit Ratio and
ii) Capital turn over ratio.

If those two ratios changes, there is a consequent change in ROI since these ratios depends on many factors which may change frequently.

V) Contribution Centre:

Contribution centre is a segment of activity of area of responsibility for which both revenues and variable cost are accumulated. CIMA defines contribution centre as "a Profit centre whose expenditure is reported on a marginal or direct cost basis." The main objective of contribution centre manager is to maximize the centre contribution. Contribution =Revenue – Variable Cost
The responsibility of a contribution centre's manager is to rising sales revenue as well as to control variable cost of production

Manager's Control over Responsibility Centres:

The manager's control over different responsibility centre and criteria for measurement of performance can be summarized with the help of the following table –

Type of Responsibility Centre	Managers has control Over	Principal Performance measurement

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Cost Centre	Cost (only Controllable cost items)	Variance analysis Efficiency measures
Profit Centre	Costs (Controllable Cost), Sales Price (Including Transfer Prices) Output volumes.	Profit
Investment centre	Costs (Controllable Cost), Sales Price (Including Transfer Price) Output volumes. Investment in fixed And current Assets	Return on investment (R.O.I) Residual Income (R.I) Other Financial Ratios

Responsibility Reporting:

Responsibility Reporting is an accounting and management reporting system directed towards controlling cost according to Responsibility centre.

It involves in defining and grouping responsibilities within an organization structure, determination and assignment of costs to appropriate levels of activities and strong emphasis and controllability. It emphasizes control on person who made responsible for executing of the plan entrusted to them and performance evaluation is done by evaluating of results in a responsibility report.

A SPECIMEN RESPONSIBILITY REPORT IS GIVEN BELOW:

Responsibility Report

Department:

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Foreman :		Month:		
Production (in u	**Budgeted (Rs)**	**Actual (Rs)**	**Variance (Rs)**	**Remarks**
Controllable Costs:				
Direct Materials	***	***	***	
Direct Labour	***	***	***	
Indirect Material	***	***	***	
Maintenance	***	***	***	
Indirect Labour	***	***	***	
Total (a)	***	***	***	
Non Controllable Costs:				
Depreciation	***	***	***	
Building Maintenance	***	***	***	
Other Allocated Cost	***	***	***	
Total (b)	***	***	***	
Total Cost (a + b)	***	***	***	

Financial Responsibilities of Centre's Managers:

The various Responsibility Centre's Managers financial responsibilities on various aspects can be summarized as under –

Type of centre	Manager Responsibility for…			
	Costs	Revenue	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

Conclusion:

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It may be concluded that the main requirement of a system of Responsibility accounting is that the organization should be such that the responsibility of each individual should be clearly defined. Each executive would know what he is required to do and what performance is expected from him with regard to the cost which is controllable by him. The system of accounting and reporting is fitted into the various responsibility areas so that the performance of each area is evaluated and reported for improvement. Thus, Responsibility Accounting lays stress on planning and cost control rather than cost ascertainment and its main advantage lies in the prompt reporting of performance or executives of various levels of management. Responsibility Centers are the ways to exercise Responsibility Accounting as well as overall control.

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