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Responsibility Accounting: A Study in Theory and Practice

KEYWORDS

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Introduction:-
Generally, in the large Companies, Responsibility Accounting is tool of a good control system. This is a system of responsibility, accountability and performance evaluation. There are many control systems in the Accountancy, they all are controlled on the whole organization, while this control system is that it is relevant to measurement of performance of divisions of an organization. Thus Budgeting and standard costing are part of the responsibility accounting process. Responsibility Accounting is very much related with the size of an organization. It is useful for the large scale companies, while small scale companies are not useful as compared to large scale.

Generally this system is useful in those companies which produce very large varity of products and works on large scale, like Hindustan Uniliver Ltd. while in small scale companies this is not as such controllable as large scale companies.

Meaning and Definition:-
Responsibility Accounting is a method of accumulating and reporting both budgeted and actual costs, by divisional managers responsible for them. In this system, business activities are identified with persons rather than products for that to make effective control to appoint a manager.

Horngren has defined responsibility accounting as, "a system of accounting that recognizes various responsibility centers throughout the organization and reflects the plans and actions of each of these centers by assigning particular revenues and costs to the one having the pertinent responsibility."

Responsibility Accounting is also defined as, "that segregates revenues and costs into areas of personal responsibility, in order to assess performance attained by persons to whom authority has been assigned."

Assumptions for Responsibility Accounting:-
Responsibility Accounting is based on certain assumptions. They are as follows:

- It should be a big company with a divisionalized organizational structure and where responsibility are classified at different levels of the organization.
- There are clearly set goals and targets for each responsibility centre.
- Managers must try to attain the goals and objectives.

Significance of Responsibility Accounting:-
The significance of responsibility accounting for management can be explained in the following way:

For Easy Identification:-
With the help of individual responsible managers we can Easy Identify that this performance is satisfactory or unsatisfactory.

For 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 proper information is available from departmental managers and all are responsible for them to make it accurate.

Planning and Decision Making:-
Responsibility Accounting helps not only in control but also in planning and Decision making.

Delegation and control:-
The twin objectives of Responsibility Accounting are delegating responsibility and with the use of that control are achieved by adoption of this system.

Objective of Responsibility Accounting:-
Following are objectives of Responsibility Accounting.

- To determine the contribution that a division as a sub unit makes to the total organization.
- 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.
- To motivate the divisional manager to operate his division perfectly with the basic goals of the whole organization.

Responsibility Centres:-
For Control purposes, responsibility Center are generally Categorized into :-

1. Cost Centre.
2. Revenue Centre.
3. Profit Centre.
4. Investment Centre.

1. Cost Centre or Expense Centre:-
It is defined by CIMA, London, as "a production or service London, function activity or item of equipment whose costs may be attributed to cost units." A responsibility of cost centre is cost centre where the manager is accountable (Considered) those costs which are under his control but not for its Revenue. Only those costs are charged to cost centre which are controllable by the manager of the cost centre.

2. Revenue Centre:-
A responsibility Centre is a Revenue Centre in which manager controls revenues but does not control cost of production / service. Revenue centre may control on selling prices, product mix and promotional activities.

3. Profit Centre:-
According to CIMA, London, a profit centre is a part of a business accountable for costs and revenues. It may be called a business centre, business unit or strategic business unit. "Un-

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der profit centre, manager determines the profit of the centre with the help of Revenue and the cost center."

4. Investment Centre:-
It is defined by CIMA, London as Investment Centre, a profit Centre whose performance is measured by its return on capital employed. "Under Investment centre, a manager is responsible for sales revenues and cost and with addition is responsible for some capital investment, this performance is measured in terms of profit as related to capital base. The manager of an investment centre is always interested to earn a satisfactory return. The return on Investment may be fixed for some period of time."

Transfer Pricing:-
When profit centres are to be used, transfer prices become necessary in order to determine the separate performances of both the buying profit centres. Generally, the measurement of profit in a profit centre becomes complicated by the problem of transfer prices. The transfer price represents the Value of goods / services furnished by a profit centre to other responsibility centres within an organization. This most commonly happens in companies with high degree of vertical integration. The transfer price is the price at which a product or service is internally transfer between two units of the same company. For example : Goods From a Holding company may be transferred to its subsidiary in a foreign country or goods from a production department may be sold to marketing department I above situations, the prices are set within a company and the typical market mechanism that fixed the product prices does not apply.

Transfer pricing is very important it directly affected with the revenues of the transferring unit and the costs of the receiving unit, Normally, it affects the divisional profits.

Mainly, there are three objectives that should be considered for setting out a transfer price.

a) Autonomy of the Division:-
The profits of one division should not be dependent on the actions of other divisions.

b) Goal Congruence:-
The transfer prices should not encourage suboptimal decision making.

c) Performance appraisal:-
The prices should enable reliable assessments to be made of divisional performance.

Methods of Transfer Pricing:-
Generally, there are four methods of transfer pricing used, they are as follows:

(1) Variable Cost Method.
(2) Total Cost Method.
(3) Market Price Method.
(4) Negotiated Price Method.

1. Variable Cost Method:-
Under this method, the transfer price is fixed at transferor unit's variable cost plus mark up, under this situation the variable cost is its opportunity cost. So that naturally, the transfer price will be comparatively low. Variable cost method may not be appropriate from the long point of view because in the long run fixed costs are also relevant.

2. Total Cost Method:-
Here, under this method, the transfer price is set at full cost which includes variable cost. Its only real advantage lies in its simplicity as it is easy to understand and implementation. However, it is not considered a desirable method because its disadvantages are more serious. This method does not provide any incentive to managers of the transferor divisions to keep costs down.

3. Market Price Method:-
Under this method, the transfer price is set at the current price of the product in the market. This method is used only when there is a ready outside market for the concerned product. In this method, needs to be adjusted for cost saving such as reduced, the selling and distribution expenses, commission on sales etc. This method is very practical because this is some what based on the decisions and situations.

4. Negotiated Method:-
Transfer price could be set by negotiation between the buying and selling divisions. This would be appropriate if it could be assumed that such negotiations would result in decisions which were in the interests of the firm as a whole and which were acceptable to the parties concerned.

Summary:-
- Responsibility Accounting is used for large Scale Companies which have various departments and each department have expert departmental responsible manager.
- Transfer pricing is the pricing of internal transfers between profit centres.
- Transfer pricing should encourage to achieve the goal, enable effective performance appraisal and maintain divisional autonomy.
- Where cost based systems are used then it is preferable to use standard costs to avoid transferring inefficiencies.
- The basic objective of responsibility accounting is to measure divisional performance.
- Various techniques used for such measurement are variable analysis, Return on Investment residual income etc.
- Price at which such transfer of goods / services / products takes place is known as a transfer price.
- Responsibility Centre is a division of the organization, where an individual manager is held responsible for its division's performance.

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