

# Examining The Role of Responsibility Accounting in Organizational Structure



## Finance

**KEYWORDS :** Responsibility Accounting, Cost centre, revenue centre, investment centre.

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### ABSTRACT

*As the centralized operations in organizations become more complicated in case of business development, the need to delegate authorities and responsibilities will depend on the size of the business. In a decentralized business organization, directors are responsible for planning and controlling the corporate operation. If the authority to manage daily operations is transferred from high-level managers to middle managers, the former will have more opportunity to focus on strategic planning. The responsibility accounting system is designed to report and accumulate costs by individual levels of responsibility. Each supervisory area is charged only with the cost for which it is responsible and over which it has control. There are three basic types of responsibility centers: cost centers, revenue centers, and investment centers. When budgeted amounts are compared with actual amounts and deviations are found, responsibility accounting can be used to find the causes of such deviation and hence improve the function. We can also determine each manager's responsibility to achieve his attainable goals in the organization. In today's dispensation, most successful managements are firmly committed to planning. They would plan and control their functional operations and as efficiently as possible. Responsibility accounting as a tool for controlling and tracing cost to individual managers, involve assessing controllable and non-controllable factors. However, determining the controllable and non-controllable factors in practice or in real life is dynamic and complex.*

### INTRODUCTION

The concept of responsibility accounting has long constituted the bedrock of management control in hierarchically structured organizations and continues to attract considerable research interest. Similar to much economics-based research on accounting, however, these advances explicitly or implicitly assume a state of equilibrium and pay hardly any attention to the social and political dynamics implicated in the process of changing systems of responsibility accounting.

At the outset, it is necessary to remember that responsibility accounting is not another branch of accounting like financial accounting or cost accounting. In fact, it is only a controlling device by which costs are traced to individual managers. In this sense, responsibility accounting is a supplementary cost control device. Till recently, most cost accounting systems which were designed to accumulate costs for the main purpose of ascertaining the product cost, emphasized general cost control. With the available controlling devices, a sincere attempt was made to ascertain and control both product costs and period costs.

However, the system did not pinpoint the individual who spent the money. As such, the system failed to fix individual responsibility for money spent. Responsibility accounting seeks to overcome this limitation by shifting the emphasis from product costing to divisional performance measurement. The basic feature of responsibility accounting is that every manager is made responsible for the activities which are under his control and his actions are measured by the revenue results achieved by him.

Performance measurement is considered as a management controlling system because economic planning and effective controlling decision-making require that each unit's function is evaluated. Some financial criteria for evaluating the corporate functions which are of greater importance include:

- Return On Investment (ROI),
- Residual Income (RI),
- Return On Sales (ROS),
- Economic Value Added (EVA),
- Market Value Added (MVA), And
- Balanced Score Card (BSC),

Among which MVA and BSC have been the most important indicators to measure performance. Moreover, using accounting data as a complement to financial measures within the Responsibility Accounting system seems so much important that requires a full explanation.

### OBJECTIVES OF THE STUDY

1. To conceptualize the types of responsibility accounting system

2. To assess the application level of different types of responsibility accounting system in various types of organization.

### RESEARCH METHODOLOGY

This research is a descriptive study in nature. The secondary data was collected from various websites.

### 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. 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.

Management uses responsibility accounting as a control device. The aim of responsibility accounting is to help management in achieving organizational goals. It is an invaluable support to modern management. It contributes to the firm's management by providing relevant information on a continuous basis.

According to Hansen and Mowen (2005), responsibility accounting model is defined by four essential elements which are: 1) Assigning responsibility 2) Establishing performance measures or benchmarks 3) Evaluating performance and 4) Assigning rewards. On the basis of these elements responsibility accounting system can be of three types- Functional-based, Activity-based and Strategic-based responsibility accounting systems.

**Figure1: Functional-based responsibility accounting system**

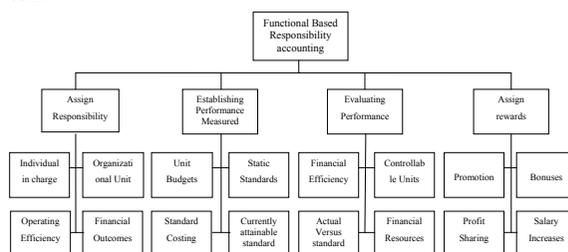


Figure 2: Activity-based responsibility accounting system

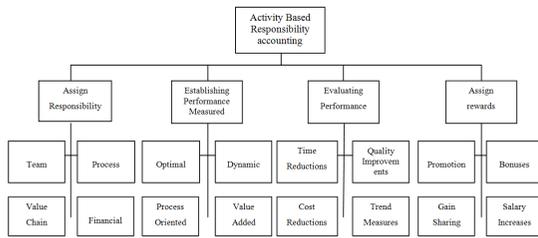
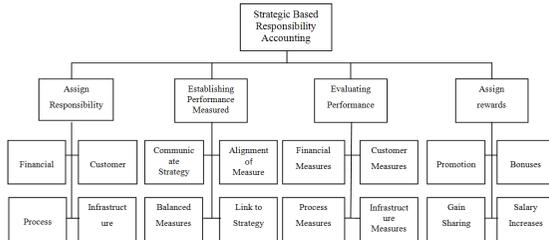


Figure 3: Strategic-based responsibility accounting system



As a control device, responsibility accounting emphasizes responsibility centers. A responsibility centre is a subunit of an organization under the control of a manager having direct responsibility for its activities.

**For control purposes there are mainly five responsibility centers:**

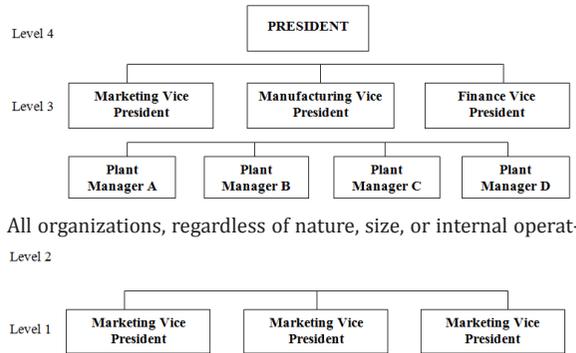
- (a) Cost center: A responsibility center, the manager of which is accountable for the subunit's costs,
- (b) Revenue center: A responsibility center, the manager of which is accountable for the subunit's revenue,
- (c) Profit center: A responsibility center, the manager of which is accountable for the subunit's profit,
- (d) Investment center: A responsibility center, the manager of which is accountable for the subunit's profit and the capital invested to generate that profit,
- (e) Contribution margin center: A responsibility center, the manager of which is accountable for the subunit's contribution margin, i.e., revenue minus variable cost

**Responsibility Accounting System**

A business organization is made up of people and resources to accomplish a certain economic goal. It is the organizational planning that determines how the elements work together to achieve the overall goals of the organization. The lines of authority should be fully defined before the responsibility system is implemented. When the powers and responsibilities are clearly determined, there will appear a level of management structure and each will make a sphere of responsibility within which individuals can make their own decisions. One basic requirement for implementing Responsibility Accounting system is the very existence of a credible organizational structure that can be illustrated by an organization chart.

One of the first requirements in developing a good responsibility accounting system is a sound organization structure, which is usually shown by means of an organization chart. In some cases, the installation of a responsibility accounting system has uncovered weaknesses in the organization structure that had to be corrected before the accounting system could be established. The next step is to develop a chart of accounts that will collect data, not by products or types of expense, but by the three types of responsibility centers noted above.

To illustrate, consider the Columbia Manufacturing Company, which produces and sells appliance parts. Costs are gathered for each cost center as needed; some are reported daily, others weekly and monthly. There are four levels of responsibility in the Columbia Manufacturing Company, as shown in Figure 4.



All organizations, regardless of nature, size, or internal operat-

Level 2

Level 1

ing structure, are vitally concerned with performance measurement. In a profit-making enterprise, owners and creditors measure management's performance through the use of financial statement ratios such as earnings per share, dividends per share, return on assets, return on stockholders' equity, coverage ratios, and debt ratio. In a governmental agency (or program), the efficiency and the effectiveness in utilizing the resources appropriated by Congress are measured by either the General Accounting Office or the agency's (or program's) internal audit staff. It should be noted, however, that performance measurement in the public sector is far more difficult to accomplish than performance measurement in the private sector because of the numerous non quantifiable factors associated with education, health care, defense, and so forth.

**Steps involved in Performance Evaluation of Responsibility Centre**

Step 1	Describe the bases of comparison used for performance evaluation.
step 2	Illustrate the use of the flexible budget in measuring performance.
Step 3	Determine alternative courses of action and indifference points in cost center decision making.
Step 4	Define a controllable income statement for the evaluation of profit center performance.
Step 5	Compute the contribution margin ratio as part of segment-oriented profit center decision making.
Step 6	Define and compute return on investment, investment turnover, and the earnings ratio.
Step 7	Identify the strengths and weaknesses of return on investment.
Step 8	Define residual income.
Step 9	Apply return on investment and residual income in investment center decision making.
Step 10	Describe the complications inherent in the valuation of controllable assets.
Step 11	Analyze changes in gross profit.
Step 12	Define and compute a volume variance, a sales price variance, and a cost variance for single- and multiple-product firms.
Step 13	Explain the role of gross profit variance analysis in the management control process.

A responsibility center's operating results for the current period, in and of themselves, is inadequate for evaluating performance. As a general rule applicable to all three types of responsibility centers, only a comparative analysis can provide upper-level management with the information needed to evaluate the performance of a responsibility center and the performance of middle- and lower-level managers.

Three bases of comparison have been commonly used in practice by companies as a means of judging the "quality" of current period performance:

1. The operating results for the prior period could be compared with the operating results for the current period to assess interperiod performance.
2. The operating results for the current period for one responsibility center could be compared with the operating results for the current period of another comparable responsibility center of the same company to assess intracompany performance.
3. The operating results for the current period for one responsibility center could be compared with the operating results for the current period of another comparable responsibility center of a competitive company, provided the data is available, to assess intercompany performance.

### Responsibility Reports

A feature of a responsibility accounting system is the varying amount of detail included in the reports issued to different levels of management. Responsibility accounting reports are classified according to different levels of responsibility. They start from lowest level of the hierarchy and continue to higher levels.

At each level, directly incurred costs by the unit's manager are listed and then the incurred costs by each of the subordinates of top managers of the unit are traced. Performance reports usually reflect the budgeted and actual financial results of the related responsibility centers. Management reporting is divided into two types: responsibility reporting and information reporting. Such reports aim to inform the manager and supervisor of how duties are fulfilled in the areas that the reporter is directly responsible and motivate them to take some actions to improve performance.

### Features of responsibility reports

#### Responsibility reports should:

- 1) Be reliable with the organizational chart;
- 2) Be prepared on time;
- 3) Be equipped at regular intervals;
- 4) Be easy to comprehend;
- 5) Be concise and succinct;
- 6) Provide comparative figures;
- 7) Be systematic and functional;
- 8) Include both Real sum and quantitative amounts when presented to operations management;
- 9) Make use of audio/video devices;
- 10) Include comparisons, proportions, and procedures.

### LIMITATIONS OF THE STUDY AND SCOPE OF FURTHER RESEARCH

This study is based on some secondary data. Only applications of responsibility accounting model and types of responsibility accounting systems have been considered but what are the reasons behind it have not been concentrated. If the study considered the activities of managers and also the qualifications of them, the finding might be different.

### CONCLUSION

Responsibility accounting is one of the best tools of cost management which is used in large organization in case of decentralization or divisionalization to reduce the difficulty of managing the organization. It means organizations follow responsibility accounting in integrated system, not any unique responsibility accounting system. As responsibility accounting is a method different from piling up costs and puts more emphasis on evaluating operations than costing production, it can cover an overall scheme consisting of all aspects of production, marketing, administrative and financial affairs within an organization by taking advantage of "planning" and "controlling" techniques. In fact, it can identify each manager with a responsibility to achieve his attainable objectives.

## REFERENCE

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