

## **Quadrant II - Notes**

**Programme:** Bachelor of Commerce (Third Year)

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**Paper Title:** Major VII - Advanced Cost Accounting II

**Unit:** 4 – Uniform Costing, Inter Firm Comparison and Responsibility Accounting

**Module Name:** Responsibility Accounting

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### **Responsibility Accounting**

#### **Concept of Responsibility Accounting**

Responsibility accounting involves accumulating and reporting costs on the basis of individual manager who has authority to make day to day decisions. Under this, the evaluation of a manager's performance is based only on matters directly under the manager's control. Responsibility accounting is also termed as profitability accounting.

In this system, the accountability is established according to the responsibility delegated to various levels of management and they are made responsible to give adequate feedback in terms of delegated responsibility. The basic idea is that each manager's performance should be judged by how he or she manages those items only which are under his control. The best way to encourage managers to achieve the desired level of performance is to measure their performance in comparison to budgeted results. Periodic comparisons of actual costs, revenues and investment with the budgeted costs, revenue and investment relating to individual managers can help management in ascertaining performance

#### **Definition of Responsibility Accounting**

According to Eric L. Kohler, responsibility accounting is defined as, "a method of accounting in which costs are identified with persons assigned to their control rather than with the products or functions."

### **Essential Features of Responsibility Accounting**

1. Information for both output and input of resources i.e. based on cost and revenue data for financial information
2. Information for planned and actual performance
3. Identification of responsibility centres
4. Transfer pricing policies
5. Performance reporting
6. To report reasons for deviation from original plan and to what extent

### **Advantages of Responsibility Accounting**

1. It establishes a sound system of control because it enables top management to delegate authority to responsibility centres while retaining overall control with itself.
2. It forces the management to consider the organisational structure to result in effective delegation of authority and placement of responsibility. It will be difficult for manager to pass back unfavourable result.
3. It encourages budgeting for comparison of actual achievements with the budgeted figures.
4. It increases interest and awareness among the supervisory staff as they are called upon to explain the deviations for which they are responsible.
5. It simplifies the structure of reports and facilitates prompt reporting.
6. It is helpful in following management by exception because emphasis is laid on reporting of exceptional matters to top management.

### **Difficulties Encountered in Responsibility Accounting**

1. Generally the prerequisites for a successful responsibility accounting scheme i.e. a well-defined organisation structure, proper delegation of work and responsibility, proper allocation of costs and a proper system of reporting are absent and this makes it difficult to have responsibility accounting.
2. It becomes difficult to have a further analysis of expenses than provided by traditional classification of expenses. For example wages of workers are controllable but the fringe benefits included in it have to be paid under the law or as per agreement with the workers' union.

3. While introducing the system, supervisory staff may require additional clarification especially in the responsibility reports. They must be explained properly, the purpose and benefits of the new system.

## **Responsibility Centres**

### **1. Cost Centre**

These are segments in which managers are responsible for costs incurred but have no revenue responsibilities. The performance of each cost centre is evaluated by comparing the actual amount with the budgeted amount. Such centres may be made according to location or person or service or type of product. It is essential to differentiate between controllable cost and uncontrollable cost while judging the performance of such centre.

A manager responsible for a particular cost centre will be held responsible for only controllable cost. Cost centres relate to cost only and they do not relate to revenues or assets and liabilities of the organization. A cost centre may be a personal or impersonal cost centre according to location. From functional point of view, a cost centre may be any of the following:

#### **a) Production Cost Centre**

It is a cost centre where production of goods is done such as in steel rolling mill, polishing, hardening and grinding departments. The number of production cost centres in a factory depends upon the nature of the industry, type of the work performed and the size of the factory.

#### **b) Service Cost Centre**

It is a cost centre which renders service to production cost centre. It is not directly engaged in production through its existence, but it is very essential for smooth and efficient running of production departments. Such cost centres like electricity or repairs or maintenance render a particular type of service for the benefit of other departments.

**c) Ancillary Manufacturing or Partly producing cost centre**

Such type of cost centres may normally be a service department but sometimes does some productive work. A packing department producing packing materials will come under this category.

**2. Revenue Centre**

It is a centre mainly devoted to raising revenue with no responsibility for production. The main responsibility of managers of such centres is to generate sales revenue. Such managers have nothing to do with the cost of manufacturing a product or in the area of investment of assets. But he is concerned with the marketing expenses of the product.

**3. Profit Centre**

This is a centre which has the responsibility of generating and maximising profits. The performance is measured in terms of both the expenses it incurs and revenues it earns. Thus a factory may constitute a separate profit centre and sell its production to other departments or the sales department. Even within the factory the service department may sell their services to the production department. This is a practice in large firms where each divisional manager is given a profit objective and his performance is measured accordingly.

**4. Contribution Centre**

It is a centre whose performance is measured by the contribution it earns. Contribution is the difference between sales and variable cost. It is a centre devoted for increasing contribution. The main responsibility of the manager of this centre is to increase contribution. Higher the contribution, better will be the performance of the manager. A manager has no control on fixed expenses because these expenses are constant.

**5. Investment Centre**

A centre which is concerned with carrying an adequate return on investment is known as investment centre. It is a centre in which a manager can control not only

revenues and costs but also investments. A manager is made responsible for properly utilising the assets used in his centre. He is expected to earn adequate return on the amount employed in the assets in the centre. Return of investment is used a basis to judge and evaluate the performance of various people.