Responsibility Accounting Practices In India

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Abstract: - It is necessary to remember that responsibility accounting is not another branch of accounting like financial accounting or cost accounting. 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. Responsibility accounting involves a company's internal accounting and budgeting. The objective is to assist in the planning and control of a company's responsibility centres—such as decentralized departments and divisions. Responsibility accounting usually involves the preparation of annual and monthly budgets for each responsibility centre. Then the company's actual transactions are classified by responsibility centre and a monthly report is prepared. The reports will present the actual amounts for each budget line item and the variance between the budget and actual amounts. Responsibility accounting allows the company and each manager of a responsibility centre to receive monthly feedback on the manager's performance.

Key words: Responsibility Accounting, Responsibility Centres, Transfer Pricing, Delegation, Decentralization.

I. INTRODUCTION

The term ‘responsibility accounting’ refers to the accounting process that reports how well managers (of responsibility centres) have fulfilled their responsibility. It is a system that measures the plans (by budgets) and actions (by actual results) of each responsibility centre. Also known as activity or profitability accounting, it is an information system that personalizes control reports by accumulating and reporting cost and revenue information according to defined responsibility centres within a company.

Responsibility accounting is a system of dividing an organization into similar units, each of which is to be assigned particular responsibilities. These units may be in the form of divisions, segments, departments, branches, product lines and so on. Each department is comprised of individuals who are responsible for particular tasks or managerial functions. The managers of various departments should ensure that the people in their department are doing well to achieve the goal. Responsibility accounting refers to the various concepts and tools used by managerial accountants to measure the performance of people and departments in order to ensure that the achievement of the goals set by the top management. Responsibility accounting as defined by (CIMA) is a system of accounting that segregates revenue and costs into areas of personal responsibility in order to assess the performance attained by persons to whom authority has been assigned. Responsibility accounting can also be referred to as activity accounting. It issued to measures evaluate and monitor decentralization process. Responsibility accounting aims to provide accounting reports. This enables every manager to be aware of all the items, which are within his area of authority. Hence, as a system of accounting it distinguished between controllable and uncontrollable cost. With Responsibility accounting, it is possible to identify or recognize decision centre within an organization for the purpose of tracing costs to the individual managers who are charged with the responsibility of making decisions about costs and revenue in an organization.

Responsibility accounting is a reporting system that compiles revenue, cost, and profit information at the level of those individual managers most directly responsible for them. The intent is to provide this information to those people most able to act upon it, as well as to judge their performance. Responsibility accounting is most commonly used in an organization that distributes responsibility down through the corporate hierarchy.

II. OBJECTIVES OF THE STUDY

1. To conceptualize the concept of responsibility accounting system
2. To assess the implementation process of responsibility accounting system
3. To know about the obstacles in implementation of responsibility accounting system

III. RESEARCH METHODOLOGY

This research paper is based on information collected from various secondary sources; articles website; journals; data
available online and various books. This study is conceptual in nature.

IV. PURPOSE OF RESPONSIBILITY ACCOUNTING

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. These segments may be called departments, branches or divisions, etc., 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. The term “division” with reference to responsibility accounting is used in general sense to include any logical segment, component, sub-component of an organization. Responsibility accounting is a technique of separating the managerial makeup into a variety of responsibility midpoints to calculate their presentation.

1. To decide the involvement that a dissection as a sub-unit creates to the overall business.
2. To offer a foundation for assessing the excellence of the divisional managers presentation. Responsibility accounting is used to calculate the presentation of managers and it.
3. To stimulate the divisional manager to function his dissection in a method dependable with the essential objectives of the business as a complete.

V. RESPONSIBILITY CENTRES

There are four types of responsibility centres:

1. **Cost Centre**: A cost or expense centre is a segment of an organization in which the managers are held responsible for the cost incurred in that segment but not for revenues. Responsibility in a cost centre is restricted to cost. For planning purposes, the budget estimates are cost estimates; for control purposes, performance evaluation is guided by a cost variance equal to the difference between the actual and budgeted costs for a given period. Cost centre managers have control over some or all of the costs in their segment of business, but not over revenues. Cost centres are widely used forms of responsibility centres.

2. **Revenue Centre**: A revenue centre is a segment of the organization which is primarily responsible for generating sales revenue. A revenue centre manager does not possess control over cost, investment in assets, but usually has control over some of the expense of the marketing department. The performance of a revenue centre is evaluated by comparing the actual revenue with budgeted revenue, and actual marketing expenses with budgeted marketing expenses. The Marketing Manager of a product line, or an individual sales representative are examples of revenue centres.

3. **Profit Centre**: A profit centre is a segment of an organization whose manager is responsible for both revenues and costs. In a profit centre, the manager has the responsibility and the authority to make decisions that affect both costs and revenues (and thus profits) for the department or division. The main purpose of a profit centre is to earn profit. Profit centre managers aim at both the production and marketing of a product.

4. **Investment Centre**: An investment centre is responsible for both profits and investments. The investment centre manager has control over revenues, expenses, and the amounts invested in the centre’s assets. He also formulates the credit policy which has a direct influence on debt collection, and the inventory policy which determines the investment in inventory.

Responsibility accounting is an underlying concept of accounting performance measurement systems. It traces costs, revenues, or profits to the individual managers who are primarily responsible for making decisions about the costs, revenues, or profits in question and taking action about them. Responsibility accounting is suitable where top management has delegated authority to make decisions. The idea behind responsibility accounting is that each manager’s performance should be judged by how well he or she manages those items under his or her control. A responsibility center is an organizational unit headed by a manager, who is responsible for its activities and results. In responsibility accounting, revenues and cost information are collected and reported on by responsibility centers.

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VI. RESPONSIBILITY ACCOUNTING COMPARED WITH OTHER CONCEPTS

<table>
<thead>
<tr>
<th>System Concept or Characteristic</th>
<th>Responsibility Accounting</th>
<th>Just-In-Time</th>
<th>Deming and TQM</th>
<th>Goldratt and TOC</th>
<th>Activity Based Management</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>How To Organize</strong></td>
<td>By function into Responsibility Centres (RC’s): Revenue centers, Cost centres, Profit centres and Investment centres.</td>
<td>Focused factories with cells. Functions connected as a network along the value chain including vendors and customers.</td>
<td>As a system so that each part understands where their inputs come from and where their outputs go to achieve the system goals.</td>
<td>Organize to maximize throughput.</td>
<td>Use JIT, FMS, CIM and activity accounting.</td>
</tr>
<tr>
<td><strong>How To Optimize</strong></td>
<td>Manage RC’s independently. Optimize the competing subsystems. Tends to ignore the inter-dependencies and requires slack. Push the work through the system. Meet static budgets.</td>
<td>Manage the system recognizing the inter-dependencies between the subsystems. High levels of teamwork and cooperation. JER and a Pull system.</td>
<td>Manage as a system as in JIT to the left. Use just enough resources (JER) and pull the work through the system. Emphasize continuous improvement (PDCA).</td>
<td>Manage constraints. Balance the flow, i.e., let the constraint (drum) set the pace. Emphasize continuous improvement by breaking constraints.</td>
<td>Manage activities to remove non-value adding work or waste.</td>
</tr>
<tr>
<td><strong>How To Measure Performance</strong></td>
<td>Management by Objectives using accounting measurements, e.g., budgets, variances. Rank employees sequentially.</td>
<td>Use non-financial critical success factors, e.g., inventory turnover, cycle time, no. of defects etc.</td>
<td>Continuously emphasize work and processes, not financial results. Can rank people in three groups, but not sequentially.</td>
<td>Throughput, inventory (i.e., assets) and operating expense. Individual evaluations are not addressed otherwise.</td>
<td>Both financial and non-financial measurements. Individual evaluations are not addressed otherwise.</td>
</tr>
<tr>
<td><strong>Type of Control System</strong></td>
<td>Accounting top down</td>
<td>Bottom up</td>
<td>Bottom up</td>
<td>Bottom up based on drum buffer rope concept</td>
<td>Bottom up</td>
</tr>
<tr>
<td><strong>Time Horizon</strong></td>
<td>Short</td>
<td>Long</td>
<td>Long</td>
<td>Medium</td>
<td>Medium</td>
</tr>
<tr>
<td><strong>The Concept of Variability or Statistical Variation.</strong></td>
<td>Ignores it. Someone is responsible for every problem or variance.</td>
<td>See the Deming column to the right.</td>
<td>Important idea. Variation can cause floating bottlenecks. Thus, a drummer is needed to balance the flow of work.</td>
<td>Recognition through the use of JIT and quality concepts. Otherwise not explicitly stated.</td>
<td></td>
</tr>
</tbody>
</table>
VII. PROCESS OF IMPLEMENTATION OF RESPONSIBILITY ACCOUNTING SYSTEM

Responsibility accounting encompasses the following steps:

1. **Identifying the Responsibility Centres**: The basis of responsibility accounting system is the designation of each sub-unit in the organization as a particular type of responsibility center. A responsibility center is a sub-unit in an organization whose manager is held accountable for specific financial results of sub-unit's activities. The important criteria for creating a responsibility center is that the unit of the organization should be separable and identifiable for operating purposes and its performance measurement should be possible. An organization can be broadly subdivided into four main responsibility centres as cost center, revenue center, profit center and investment center.

2. **Delegation of Authority and Responsibility or Decentralization**: To increase managerial and operational efficiency, the manager of each subunit should be assigned specific authority and responsibility for the activity of that division. No one can be held accountable without having any prior responsibility and responsibility always accompanies corresponding authority. Responsibility centers are the decision centers also, and the decision requires the power or authority.
   - Performance Management
   - Business Opportunities
   - Performance Review

3. **Controllable of the Object**: The manager of a cost center can be held accountable only for the costs, which are controllable by him. Therefore, it is an essential part of responsibility accounting to identify the controllable and non-controllable costs. The same thing applies in the case of revenues, profits and investment.

4. **Establishing Performance Evaluation Criteria**: Main purpose of responsibility accounting is to measure the divisional or subunit performance. Performance evaluation is a yardstick measurement of whether the results are obtained as ought to be or not. Most often the following criteria are applied for divisional performance evaluation.

5. **Electing Cost Allocation Bases**: Divisional profitability heavily depends on the bases of allocation of joint overheads and corporate overheads. Switching from one method to another of cost allocation over the products or divisions, product wise profitability change to a great deal. Remember that for decision-making purpose, such allocated overheads should be carefully treated and well understood.

VIII. NEED OF RESPONSIBILITY ACCOUNTING

These are the following reasons to implement responsibility accounting system:

1. **Decentralization**: By dividing the total organization in smaller subunits, the organization becomes more manageable.

2. **Performance Evaluation**: Responsibility accounting establishes a sound and fair system of performance evaluation of each manager and personnel. The performance of each responsibility center is measured and presented periodically on performance report.

3. **Motivation**: Responsibility accounting emphasizes on the individual achievement-based performance evaluation. Therefore, the job becomes more challenging for the employees and motivates them to use their full potentiality in achieving the results.
   - Business Opportunities
   - Online Bank
   - Online Banking
   - Revenues

4. **Transfer Pricing**: Responsibility accounting divides the organization in different autonomous responsibility centres or subunits. In such circumstances, product or service of one division or unit can be transferred to another division or unit within the same organization charging a transfer price. This creates an inter-competitive environment to make each subunit of the organization more profitable and efficient.

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*Standard Costing
* Budgetary control
* Profitability ratios
* Valuation measures

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5. *Drop or Continue Decision*: If the organization is divided into subunits, it becomes possible to measure division wise or product wise profitability of the organization. If saving in costs exceeds the foregone revenues, the center can be discontinued.

**IX. TRANSFER PRICING**

Transfer pricing is the setting of the price for goods and services sold between controlled (or related) legal entities within an enterprise. For example, if a subsidiary company sells goods to a parent company, the cost of those goods paid by the parent to the subsidiary is the transfer price. Legal entities considered under the control of a single corporation include branches and companies that are wholly or majority owned ultimately by the parent corporation. Certain jurisdictions consider entities to be under common control if they share family members on their boards of directors. Transfer pricing can be used as a profit allocation method to attribute a multinational corporation's net profit (or loss) before tax to countries where it does business. Transfer pricing results in the setting of prices among divisions within an enterprise.

In principle, a transfer price should match either what the seller would charge an independent, arm's length customer, or what the buyer would pay an independent, arm's length supplier. While unrealistic transfer prices do not affect the overall enterprise directly, they become a concern for government taxing authorities when transfer pricing is used to lower profits in a division of an enterprise located in a country that levies high income taxes and raise profits in a country that is a tax haven that levies no (or low) income taxes.

Transfer pricing is the major tool for corporate tax avoidance also referred to as Base Erosion and Profit Shifting (BEPS).

**X. 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.

**Comparable uncontrolled price (CUP)**

Most systems consider a third party price for identical goods, services, or property under identical conditions, called a comparable uncontrolled price (CUP), to be the most reliable indicator of an arm's length price. All systems permit testing using this method, but it is not always applicable. Further, it may be possible to reliably adjust CUPs where the goods, services, or property are identical but the sales terms or other limited items are different. As an example, an interest adjustment could be applied where the only difference in sales transactions is time for payment (e.g., 30 days vs. 60 days). CUPs are based on actual transactions. For commodities, actual transactions of other parties may be reported in a reliable manner. For other items, "in-house" comparable, i.e., transactions of one of the controlled parties with third parties may be the only available reliable data.

**XI. LIMITATIONS OF RESPONSIBILITY ACCOUNTING**

The main idea underlying the responsibility accounting concept is that separating a company into responsibility centres provides an adequate way to manage a large diversified organization. However, responsibility accounting causes some problems as indicated below.

Responsibility accounting suffers from the following limitations:

1. The prerequisites for a successful responsibility accounting system are:
   (a) A sound organisational structure where divisions can be identified clearly as responsibility centre.
   (b) Proper delegation of work and responsibility.
   (c) A proper system of reporting.

   If these conditions are absent it is difficult to have a responsibility accounting system.

2. The traditional way of classification of expenses needs to be subjected to a further analysis which becomes difficult.

3. In introducing the system certain managers may require additional classification particularly if the responsibility reports are different from routine reports.

**XII. SUMMARY AND CONCLUSION**

Responsibility accounting is one of the best tools of cost management which is used in large organization in case of decentralization or divisionalisation to reduce the difficulty of managing the organization. Responsibility canter...
identifiable segments within a company for which individual managers have accepted authority and accountability. Responsibility centers define exactly what assets and activities each manager is responsible for. Managers prepare a responsibility report to evaluate the performance of each responsibility center. This report compares the responsibility center’s budgeted performance with its actual performance, measuring and interpreting individual variances. Responsibility reports should include only controllable costs so that managers are not held accountable for activities they have no control over. Using a flexible budget is helpful for preparing a responsibility report.

- 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 centers.

- Responsibility Centre is a division of the organization, where an individual manager is held responsible for its division’s performance.

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