Examining the Role of Responsibility Accounting in organizational Structure

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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.

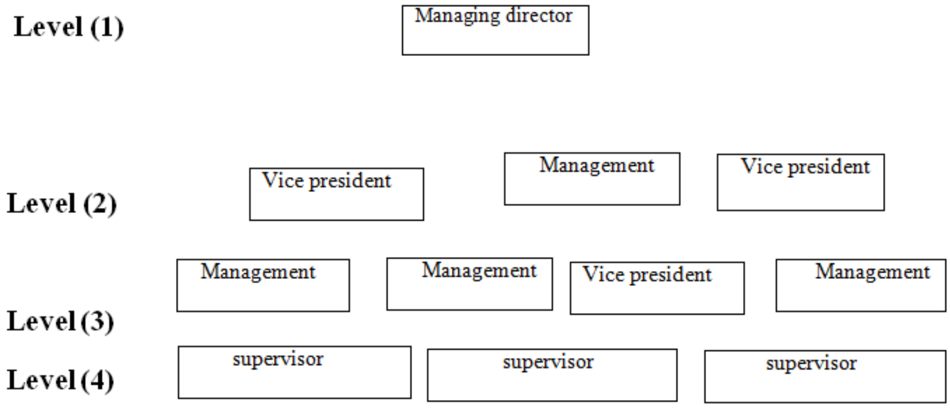
1 Introduction

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 BSC, among which MVA and BSC has 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.

2 Business Structure

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.



3 Definition of Responsibility Accounting:

An accounting system that collects and reports revenues and costs data by areas of responsibility. Planning such a system is based on the assumption that managers should be accountable for their own actions, the actions of their subordinates, and any activities performed in their responsibility center. People inside the organization should also be held accountable and responsible for their own actions and the actions of those under their charge. Responsibility Accounting, as the profitability accounting, is also called Activity accounting.

4 Responsibility Accounting reports:

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 consistent with the organizational chart; 2) be prepared on time;
3) be prepared at regular intervals; 4) be easy to understand;
5) be brief and concise; 6) provide comparative figures;
7) be analytical and applied; 8) include both Rial sum and quantitative amounts when presented to operations management;
9) make use of audio/video devices; 10) include comparisons, proportions, and procedures.

Analysis of deviations and Responsibility Accounting:

Budgeted amounts and deviation analyses has been repeatedly emphasized in performance reports. So, the concepts of budgeting, deviation analyses and responsibility accounting are closely related to each other. According to the data found in a flexible budget, it would be possible to compare the actual revenues, costs and profits with their

budgeted amounts. Obviously, budgeted amounts can be compared with actual amounts if both are collected for the same level of activity.
Deviations between budgeted and actual amounts should be split into their components to find the causes of deviation and improve performance. Therefore, deviation analysis acts as an important and effective tool of responsibility accounting. To create control reports, cost items can be classified into engineering costs, planning costs, and capacity related costs.

Engineering costs:

The relation between input (cost items) and output can be found by considering products technical specifications or studying the cost items analysis.

Planned Costs:

We cannot find a clear relationship between costs , inputs and outputs. However, management can revise the planned expenses during the budget year.

Capacity-related Costs:

Costs incurred to establish facilities for production and distribution in administrative organizations. This group of cost items appears when decisions are made to expand factory facilities or enhance the administrative capabilities. Such items are usually regarded as committed and cannot be easily changed within a short period of time.
Direct material and labor are part of engineering expenses for which a standard can be set. Comparing the actual and standard cost items at a certain level of production is an effective tool for exerting management control.

Direct material price deviation

This deviation is reported to business manager at the time of purchase.
Direct material consumption deviation: this deviation is reported monthly, but daily control of material is conducted based on examining extra requests and measuring the waste produced.

Direct efficiency wage deviation:

This deviation is reported monthly and the report is prepared based on the operation of production units. However, in order to exert daily control, deviations from working time are measured for each worker by using time cards.

Direct wage rate deviations:

Such a deviation, normally reported to the production manager or supervisor, occurs when the work is done by the workers whose wage rate is different from the standard rate set up for such a labor. The standard rate is set up based on engineering features and a certain level of skill required for the job.

Responsibility accounting helps the management accounting by using appropriate devices to set the goals for sub-units and production units and coordinate their goals. To do this, a trade organization is divided into a number of responsibility centers as cost center, revenue center, profit center, and investment center.

Each of these responsibility centers of a trading unit provides a performance report which reflects the unbudgeted amounts, actual amounts and deviations and the analysis of deviations. Measurements based on performance reports will improve the performance of the trading unit, motivate employees, and helps planning for future operation. So, the concepts of budgeting, deviation analysis, and responsibility accounting are closely interrelated.

Cost center:

A department within an organization whose manager is accountable for the subunit's costs.

Profit center:

A department within an organization whose manager is accountable for the profits incurred by the center. Profit center managers are also responsible for the revenues and costs related to the unit under their own control and they have greater responsibility than cost center.

Investment center:

A department within an organization whose manager is accountable for the profit earned by his sub-unit and the associated capital. Managers of this center have all the responsibilities of profit center managers as well as the authority to expand or restrict the organizational activities. Investment centers usually consist of some profit centers which are made from a combination of cost and revenue centers.

5 Performance measurement indicators

a)Modern indicators

Economic value added (EVA) refers to the profit of a business unit after deducting tax charge and cost of capital. To measure the cost of capital, the average weighted cost of two sources of supply (loans and sale of shares) is calculated. In calculating the economic value added, management attention is focused towards shareholders. By measuring profit after deducting the expected return, EVA reflects economic profitability. Moreover, it may follow-up stock prices more accurately than revenues, earnings per share, return on shareholders' investment, or other indicators of accounting. It is also supported by experimental studies.

The goal of EVA as a management tool makes the managers behave in such a way that they own the trading organization. Under EVA ownership proposal, cash rewards to employees are paid based on EVA. If this proposal is used along with the common employee rewards (authority to purchase share by employees), shares or other securities based on EVA can be transferred to the employees instead of paying cash rewards.

EVA Applications:

Internal Applications: a management tool for performance measurement, comprehensive criterion for productivity measurement, tool for relating ownership to the business management, and tool for complying costs with revenues.

External Applications: a tool for investment, standard for stock price forecasting, tool for measuring value creation, a framework for financial management, and an effective framework for organizational culture and promoting the working quality of employees

Market Value Added (MVA):

It can be used to measure external performance and is calculated by comparing the average market value of shareholders' equity with the book value of their equity.

To have a correct analysis of this performance, positive changes every year should be considered. Because comparing these changes in EVA every year is important regarding the total share and securities as these market values are influenced by interest rates and quantitative economic conditions.

1)Return on Investment (ROT)

Accounting standard resulting from operating profit divided by investment profit.
ROT includes all profitability elements (revenue, cost, and investment).

2)RT

It is profit subtracted from expected returns on investment. Or:
RT= operating profit – (expected returns ratio × investment)
The expected returns ratio multiplied by the related costs investment is called the imputed cost. Such costs are not identified in accounting as they are not differential costs. They reflect the use of cash funds in different investments having similar risks.

Return on Sales (ROS)

The ratio of operating profit to revenue is called the return on sales.
ROS is a component of ROI in the analytic profitability approach of DuponT.

Earnings per Share (EPS):

A traditional and common indicator for performance measurement which can also be used for evaluating stock price. It is calculated as net income of common shareholders divided by the number of shares of common stocks. High-quality EPS means that the number is a relatively true representation of what the company actually earned.
Price-Earnings Ratio (P/E): It is an indicator for performance measurement in the investment market and shows that how much investors are ready to pay to get $1 profit per share. Experience has proven that high P/E, even higher than 20, typically belongs to young companies with rapid growth and high risk. While grown-up industries with slower growth have lower P/E. Investing in stocks with lower P/E not only involves lower risk but is also more rewarding.

6 Conclusion

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.

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