UNIT 4  RESPONSIBILITY CENTRES

Objectives
After you have studied this unit, you should be able to:

• understand and explain the concept of responsibility centres in the context of an organization;
• should be able to integrate the organization structure and responsibility centres;
• identify the major problem areas to be tackled for the successful introduction of responsibility centres; and
• understand the basic requirements for the design of a simple system for the evaluation of responsibility centres.

Structure
4.1 Introduction
4.2 Delegation and Responsibility Centres
4.3 The Concept of Responsibility Centres
4.4 Organization Structure and Responsibility Centres
4.5 Types of Responsibility Centres
4.6 Establishing Responsibility Centres
4.7 Performance Evaluation of Responsibility Centres
4.8 The Concept of Responsibility Accounting
4.9 Summary
4.10 Key Words
4.11 Self Assessment Questions
4.12 Further Readings

4.1 INTRODUCTION

In small organization, decision-making and management of business are often done by a single individual. However, as the organization grows and becomes larger, the business complexities arise and it becomes rather unmanageable by one person alone. He, then, is forced to take help of many persons to achieve the objectives of the organization. As he is not in a position to take all the decisions himself, he has to seek help from others in this respect. Thus, he has to share the authority of decision-making and responsibility with others. Sharing of the authority and responsibility may be taken as delegation, which goes along with the divisionalization and segmentation. When the decision-making authority is delegated to person in charge of a division or a segment, known as ma lagers, they have to be held responsible for the consequences of their decision and making. This necessitates evaluation of the managers, who have taken decision and, thus, making them duly accountable for what they have done. This process requires establishment of responsibility centres in the organization. A responsibility centre may be defined as an area of responsibility which is controlled by an individual. The responsibility centres require establishment system of accumulation, absorption and allocation of costs to identifiable responsibility centres. Robert N. Anthony and Vijay Govindarajan has defined responsibility centre is an organization unit that is headed by a responsible manager. A company is a collection of responsibility centre. At the lowest level of hierarchy in a company sections or work shits are responsibility centres. At the
higher levels are departments or strategic business units which consists of the smaller units, staff and management. At the level of senior management and Board of Directors whole of the company is a responsibility centre.

### 4.2 DELEGATION AND RESPONSIBILITY CENTRES

Determining the responsibility centres in an organization depends upon the philosophy, strategy followed by an organization or company concerned. However, no set pattern, can be followed in this respect by all the companies. It will depend upon nature, size, and area of operation of the company concerned. Even the environmental factors have to be considered for it.

There are several ways of delegating the authority and associated responsibility. The company management would have to consider and identify key factors for it. They may undertake delegation on the basis of functional responsibilities, such as production, marketing and finance. They may consider product lines and geographical location of the business also as the key factors.

**Functional Delegation**

In many organizations authority and responsibility is delegated on the functional basis of production, marketing and finance. One individual will be given the decision making authority and the responsibility for all the production activities, another for all the marketing activities and yet another for all finance activities. This pattern of delegation is illustrated in Exhibit 4.1

**Exhibit 4.1: Functional Organization**

![Functional Organization Diagram](image1)

**Product Lines**

Some organizations delegate authority based on product lines of the company. A single manager will be responsible for the different functions of production, marketing and finance for the particular production lines. This type of delegation is followed normally by companies who choose to organize themselves into strategic business groups. These product line managers may in turn delegate their decision making authority and responsibility to various subordinate functional managers, namely, production manager, marketing manager and finance manager. Exhibit 4.2 illustrates delegation based on product lines.

**Exhibit 4.2: Product Line Organization**

![Product Line Organization Diagram](image2)
Geographical Regions

Geographical delegation of authority and responsibility is normally resorted to for the simple reason that customs and characteristics of the people, market and the business environment may vary considerably from area to area. This is even more so in the case of multinational companies operating worldwide. It is a common practice to segregate the organizations on the basis of domestic and foreign operations. In India, it is a common practice for companies operating throughout the country to divide their operations into four or more geographical regions of the country. Exhibit 4.3 illustrates patterns of delegation based on geographical division of the operations.

The pattern of delegation followed by different companies will be determined more by the philosophy and leadership style followed by the top management. Apart from management style and philosophy the complexity of operations of the organization is another important factor. In most cases when organizations become multi-technology, the sheer need for specialized knowledge compels delegation.

Another major criterion for delegation is the economic consideration. When the cost or benefit arising out of wrong or right decisions is large then the decisions may probably not be delegated. Hence, you will find decisions involving long term impact on the company and large financial implication are seldom delegated. However, most decisions involving day-to-day operations are delegated in most cases.

In some cases, the delegation of authority may not be helpful or followed in practice. When the cost or benefit arising out of wrong or right decision is large, it will not be very useful to undertake delegation. Similarly, decisions involving long-term impact, on the company and which involves huge funds need not be delegated and such decisions have to be undertaken by the top management only. However, the decisions involving day to day operations may be delegated, without any difficulty,

Exhibit 4.3: Geographical Organization
Activity 1

Please answer by completing the blanks:

a) Some of the key factors considered by companies in delegation authority in the organization are:

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b) Functional delegation involves delegation of authority on .................
………………………………… of the business namely ....................... and.........................

Activity 2

Briefly answer the following questions:

a) Why do firms delegate?
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b) What factors usually determine delegation?
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b) Can you recall the common forms of delegation?
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b) How do the different forms of delegation differ?
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4.3 THE CONCEPT OF RESPONSIBILITY CENTRES

The establishment of responsibility centres have become quite essential in a large organization. As the complexity of the organization grows, it becomes quite imperative. Today, the companies are facing a lot of challenges due to increasing competition, as we are moving towards more and more liberalization and globalization. It has necessitated effective control and management of various operations of the company concerned. This challenge of the competition can be met by recognizing three key principles. They are: (1) delegation of responsibility for specific to successive lower levels of the organizations (2) motivation of the level of management to which a certain task has been delegated and (3) measurement of achievement of the specified objectives. The organization structure followed in this framework is mostly pyramidal. Under it, the lower level managers report upward towards their superior as the superiors delegate their authority to lower levels.

In this process of delegation of authority to different levels or segments of the organization, there is a need for proper and adequate delegation of authority and responsibility so that there is neither overlapping nor gaps. It is quite necessary and important to decide about the nature and level of delegated authority at the time of establishing responsibility centres.

The key factor or consideration for determining the responsibility centres is its ability to control cost or revenue. As effective control implies controlling cost and revenue. In fact, the effective planning and control system are structured around the implicit or explicit centres of responsibility within the organization. The managers at different levels should have a clearly defined area of responsibility if their proper evaluation is to be undertaken.

The responsibility centres too have to be evaluated on the basis of set criteria which may be as follows;

i) Comparison with budgets and targets;
ii) Comparison among different division within the company;
iii) Comparison with historical results;
iv) Comparison with industry averages.

4.4 ORGANIZATION STRUCTURE AND RESPONSIBILITY CENTRES

At the time of establishing responsibility centres, the existing organization structure should be properly reviewed often, in practice, it requires a change in the existing organization structure. In view of that, following changes may be quite necessary in it:

1) The responsibility for all the revenues and expenses must be assigned to identified competent individuals in the organization.

2) The accounting system should be modified as to accumulate and report expenses and revenues on the lines of assigned responsibilities within the organization.

3) A system of evaluation based on comparison of revenues and expenses of different responsibility centres with pre-assigned targets should be established: If the suitable and necessary changes are not undertaken in the existing organization, the purpose will not be responsive to the needs, required in this connection.

The responsibility centre has to be kept under the control of competent persons. In practice, there may be difficulty in identifying such persons. It is also found that several expenses are controllable not by one such centre but by different centre. Similarly, expenses may also be controlled at different levels. Reallocation of expenses from one units, to another may often become quite necessary.
Any desired change in the organization should not be taken in isolation. It should be taken as a part of integrated change otherwise several practical problems may arise later. In fact, the responsibility structure should be on the lines of integrated organization structure and there should be clear definition of responsibility at different levels.

Activity 3

a) What are the essential changes to be effected for a responsibility centre system to meet the needs of a decentralized organization?

b) Can you describe the relationship between organization structure and responsibility centre?

4.5 TYPES OF RESPONSIBILITY CENTRES

The responsibility centres can be classified keeping in mind two important factors. They are; (a) the scope of responsibility assigned and (b) the decision making authority given to individual managers. These are four types of responsibility centres. They are given as follows:

1) Expense Centre

It is also known as cost centre. A cost or expense centre is a segment and division of an organization in which the managers are held responsible for the cost incurred in that segment. They may not be responsible for revenue. The expense centre managers have control over some or all of the costs in their segment of business but not over revenues. In a manufacturing organization, the production and service departments are classified as expense centres. In a marketing department, a sales region or a single sales representative may be taken as expense centre. The expense centre managers are responsible for the costs that are controllable by them and their subordinates. There are two general type of expense centres 1) Engineered expense centers 2) Discretionary expense centers they correspond to two type of costs. Engineered cost are those elements of costs which can be predicted with fair degree of accuracy e.g. cost of raw material, direct labour, water and electricity etc. Discretionary cost (also called managed costs) are costs for which output can't be measured in monetary terms, e.g. are administrative and support units like accounts department, legal department, public relations department, research and development department, most of the marketing activities etc.

2) Revenues Centre

Revenue centre is a segment of the organization which is primarily responsible for generating sales revenue. The revenue centre manager has control over expenses of the marketing department but he has no control over cost, or the investment in assets. The performance of revenue centre managers is evaluated by comparing actual revenues with the budgeted revenue and actual marketing expenses with budgeted marketing expenses.
3) **Profit Centre**

Profit Centre is a segment of business often called a division that is responsible both for revenue and expenses. In a non-profit organization, the revenue centre may be used instead of profit centre, as profit is not the primary objectives of such organization. The main purpose of profit centre is to earn the targeted profit. In fact, the profit centre managers are more concerned with finding ways to increase centre's revenue by increasing production or improving distribution methods. The performance of the profit centre is evaluated in term of whether the centre has achieved its budgeted or target profit or not.

4) **Investment Centre**

An investment centre is responsible for the profits and investment. If a manager controls investment, that area of responsibility can be called as investment centre. He is responsible for the returns on the investment. He is required to control the amounts invested is the centre's assets. The manager of investment centre has more authority and responsibility than the manager of either cost centre or profit centre.

Exhibit 4.4 shows different type of responsibility centres and relationship between inputs and output. Table 4.1 shows some of the items of a financial statement and the responsibility of the managers of revenue centre, cost centre, profit centre and investment centre regarding these items.

**Table 4.1: Examples of various type of Responsibility Centres**

<table>
<thead>
<tr>
<th>Financial Statement Items</th>
<th>Statement</th>
<th>Cost Centre</th>
<th>Profit Centre</th>
<th>Investment Centre</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Trading and Profit &amp; Loss Statement</strong></td>
<td>Revenue</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td></td>
<td>Cost of goods sold</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td></td>
<td>Gross profit</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td></td>
<td>Advertising</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td></td>
<td>Research &amp; Development</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td></td>
<td>Other expenditure</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td></td>
<td>Corporate income tax</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td></td>
<td>Profit before tax</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td><strong>Balance Sheet</strong></td>
<td>Fixed Assets</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Current Assets</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Current Liabilities</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Long term debt</td>
<td>X</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(X indicates that responsibility centre manager is accountable for some elements included in the financial statement)

Relationship between different Responsibility Centres

When the whole company is treated as a profit centre it may have one or more expense responsibility centres. If a company has more than one profit centre, each profit centre will have one or more expense responsibility centres. It may also have a corporate...
expense responsibility centre to which all expenses, which are not incurred specially for profit centre, may be charged. For example, general administration expense of corporate office may be charged to appropriate corporate expense responsibility centre.

**Characteristics of a Responsibility Centre**

An effective responsibility centre should have the following characteristics:

1) It is a cleared defined segment of an organization.

2) A designated individual is responsible for its performance; namely, the output produced by the segment as well as inputs consumed by the segment.

3) The designated individual has the necessary authority to discharge the assigned responsibilities.

The usual forms of responsibility-centres in different organizations vary widely. It can be the entire company, business units, product divisions, sales branches, sales regions, Functional departments such as production, marketing, personnel and finance or their subdivisions.

**Illustration**

Ibis Apparels is organized with clear delegation of responsibilities. The production manager is responsible for all the activities relating to production. Similarly, the marketing manager is responsible for all activities relating to the marketing of products, Vice-President; Apparel Division is responsible for the profits of the division. However, only the president is responsible for the investment decisions for the different divisions of the company.

The management control structure of Ibis Apparels is presented in Exhibit 4.5.

As presented in Exhibit 4.5 the management control structure of Ibis Apparels is structured into responsibility centres as follows:

<table>
<thead>
<tr>
<th>Designation</th>
<th>Responsibility Centre</th>
</tr>
</thead>
<tbody>
<tr>
<td>President</td>
<td><strong>Investment Centre:</strong> Responsible for all investment decisions and hence to be evaluated on the basis of performance of Return on Investment (ROI)</td>
</tr>
<tr>
<td>Vice-President</td>
<td><strong>Profit Centre:</strong> Responsibility for all the revenues and expenses Apparels Division of the division and hence responsible for the profits of the division; to be evaluated on the basis of profit performance either in terms of achievement of budgeted performance or in terms of margin on sales</td>
</tr>
</tbody>
</table>
Management Control Structure

<table>
<thead>
<tr>
<th>Production Manager</th>
<th>Expense Centre: Responsible for production and hence responsible for all the expenses to be incurred for production; to be evaluated on the basis of achievement of budgeted targets of production and control of expenses within budgets and or a certain inputs-output relationship.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Apparels)</td>
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</table>

<table>
<thead>
<tr>
<th>Marketing Manager</th>
<th>Revenue Centre: Responsible for all the revenues of the decision; to be evaluated on the basis of achievement of the budgeted targets</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Apparels)</td>
<td></td>
</tr>
</tbody>
</table>

Activity 4

a) Try to draw the organization chart of Ibis Apparels based on the above information relating to responsibility centres.

b) Can you identify the four major elements to be controlled in any organization?

c) Can you describe different responsibility centres in terms of the major elements to be controlled in any organization?

It should be noted that the responsibility of the expense centre and profit centre may be further delegated to subordinate responsibility centres. From the above we can visualize the hierarchy of responsibility centre in case of Ibis Apparels as

Exhibit 4.6: Ibis Apparels-Hierarchy of Responsibility Centre
Establishment responsibility centres in an organisation is not an easy task. It must be carefully planned and executed. Some of the major steps involved in the process can be described as follows:

1) Study the organization structure, authority-responsibility relationships or job descriptions, layout of the factory and office, various activities, production process and structure of the production flows, and the interrelationships among these different activities. Based on this study, list all the different operations and activities, functions and tasks in the terms.

2) Define each activity in descriptive terms.

3) Evaluate the need for any reorganization required in the context of establishment of responsibility centres and develop an organization structure on the lines of desired responsibility centres.

4) Delineate the organization into various responsibility centres. Ensure that the centres so established satisfy the three characteristics of a good responsibility centre.

The establishment of centres can be considered a tentative starting point for evaluation against the following factors:

- The objectives of the system which will govern the number and type of responsibility centres, the need for cost information relating to a particular activity;
- The need for flexibility for supplying cost information for occasional requirements;
- Ease in allocation of costs, measurement of performance and evaluation of variances;
- Future needs of the organization at least to the extent known from corporate or strategic plans;
- The volume of information and paperwork to be contended with;
- Segregation of production departments and service departments;
- Comparison of the planned responsibility centres with those of a similar company; and
- A system of coding of the responsibility centres for easy recording and retrieval of information. This can also integrated with account numbers.

**Activity 5**

Draw up a flow chart of activities for establishing responsibility centres in an organization with which you are familiar.

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4.7 PERFORMANCE EVALUATION OF RESPONSIBILITY CENTRES

After assigning the necessary authority and responsibility to individuals at different centres, it becomes quite necessary to undertake evaluation of their performance. Any performance evaluation has to be done taking into account the objectives set as well as the predetermined criteria set for them. The objectives may be different for different responsibility centres. For example, for expense centre, it would be minimizing cost, for revenue centre, it would be maximizing sales revenue, for the profit centre, it would be maximizing profits and for investment centre, it would be maximizing return on investment.

The overall performance evaluation concept applied to various responsibility centres is given in the following Table 4.2

<table>
<thead>
<tr>
<th>Types of Centres</th>
<th>Control Variable of the Centre</th>
<th>Variable Predetermined by Top Management</th>
<th>Objective</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expense Centre</td>
<td>Prices and quantities of inputs</td>
<td>Prices and quantities of input/budget</td>
<td>Minimize cost</td>
</tr>
<tr>
<td>Revenue Centre</td>
<td>Prices and quantities of inputs</td>
<td>Quantities to be sold/budget</td>
<td>Maximize sales revenue</td>
</tr>
<tr>
<td>Profit Centre</td>
<td>Prices and quantities of inputs and outputs</td>
<td>Investment</td>
<td>Maximize profit</td>
</tr>
<tr>
<td>Investment Centre</td>
<td>Price and quantities of inputs and outputs and investment</td>
<td>None</td>
<td>Maximize return on investment</td>
</tr>
</tbody>
</table>

Activity 6

Can you enumerate major consideration in performance evaluation of responsibility centres?

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4.8 THE CONCEPT OF RESPONSIBILITY ACCOUNTING

The responsibility accounting refers to the accounting process that reports how well various divisional managers, responsible for the various centres, have fulfilled their responsibility. It implies, in fact, information system that personalized control reports by compiling and reporting cost and revenue information according to responsibility areas within an organization.

The responsibility accounting, according to Chonles T, Horngren, assigns particular revenues and costs to the individuals in the organization who has greatest potential day-to-day influence over them. However, its purpose is not to place blame. Rather, it is to evaluate performance and provide feedback so that future operations can be improved.
The responsibility accounting implies that an individual should be responsible for those items or activities which they can control. They should not be responsible for those items or activities over which they do not have any control.

Under the framework of responsibility accounting, an expense centre, viz., becomes an accounting centre for accumulating allocation or absorption of expenses, such accumulation helps in generating necessary information required for the top management to effect control over the activities of the responsibility centre. In fact, the responsibility accounting is the information processing system used in consonance with the responsibility centre.

**Activity 7**

What is responsibility accounting? How does it differ from responsibility centres?

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4.9  SUMMARY

Increasing complexity of business demands more effective management control systems. One of the major steps in this direction is the delegation of authority and the assignment of responsibility for the achievement of specified results. Responsibility centres form an important tool in this effort. The very objective of responsibility centre is that a certain individual in an organization is held responsible for the operations under his control in terms of inputs and outputs. The responsibility centres are evaluated for their performance. Responsibility accounting provides the necessary support for such a system by accumulating and reporting relevant information relating to activities of different responsibility centres.

4.10  KEY WORDS

**Delegation:** Process of assigning the authority for taking decision and the associated responsibility to a designated individual in an organization.

**Expense Centre:** A segment of the organization where the managers' sphere of control is over expenses.

**Investment Centre:** A segment of the organization where the manager is responsible for exercising control over the investments made and hence responsible for the return in relating to the investments.

**Profit Centre:** A segment of the organization where the manager is responsible for both revenue and expenses and hence expected to exercise control over profits to be earned by the segment.

**Responsibility Centre:** A segment of the organization in charge of a designated individual responsible for the achievement of specific objectives set for that segment.

**Responsibility Accounting:** Responsibility accounting is the structuring of the information processing system through which information is identified and reported for different responsibility centres.

**Revenue Centre:** A segment of the organization where the manager is responsible for the revenues earned by that segment.
4.11 SELF ASSESSMENT QUESTIONS

1) Why do organizations delegate authority and responsibility?

2) What are the commonly used basis of delegation in organizations? How do they differ?

3) Explain responsibility accounting. What are the essential requirements of effective responsibility accounting?

4) Choose the right answer from the given alternatives for the following questions.

5) An investment centre will have:
   a) Authority to make decisions affecting major factors determinants of profits including choice of markets, prices, sources of supply and nature of customers.
   b) Authority to make decision over all costs of operations including choice of suppliers.
   c) Authority to make decisions effecting the major determining profits such as choice of markets, sources of supply and significant control over investment in assets used by the segment,
   d) Responsibility for developing markets and vendors for the organization.

6) A profit centre will have authority and responsibility to make decision relating to:
   a) Major factors affecting profits including choice of suppliers and markets for sale of products.
   b) All investments in the division, choice of suppliers and markets and setting prices.
   c) All aspects of costs of operations of the organization.
   d) All the element of input going into the final output.

7) An expense centre has:
   a) Responsibility for putting together material and labour to produce the final output.
   b) Responsibility over all expenses incurred in the organization.
   c) Responsibility for developing markets for selling output.
   d) Authority to make decisions over significant aspects of costs including the power to choose sources of supply.

8) Suburban Nursing Home is situated on the outskirts of Calcutta. The nursing home caters to the middle class population in the suburbs. It is found that the number of patients at the nursing home increases during the monsoon months of June to August.

   An MBA from one of the leading Institutes in the country was hired to improve the management of the nursing home which was all along managed by its medical staff. The new general manager introduced a system of management control for the nursing home including responsibility accounting. The changes envisaged provision of quarterly cost reports to department heads. Earlier, there was no system of regular cost reporting to the department leads.
The General Manager wrote to all the departmental heads about the introduction of management control system. Highlights of the communication from the GM were as follows:

We have introduced responsibility accounting system for the nursing home. All the departmental heads will be provided with quarterly reports showing the budgeted and actual expenses for the period. The report will show the variations from the budget. The essence of the control system is that you are responsible for the expenses in yours department and for controlling the same within the budget. The variations are highlighted to enable you to identify which items of expenses are out of control and the size of variation will indicate the ones, which are crucial. You can concentrate your effort towards control on such variations or exceptions. We call this management by exception, we are providing below the last quarter reports:

The General Manager wrote to all the department heads about the budget. The essence of the control system is that, you are responsible.

### Suburban Nursing Home
**Performance Report-Catering Department**
**June-August 19X1**

<table>
<thead>
<tr>
<th></th>
<th>Budget (Rs.)</th>
<th>Actual (Rs.)</th>
<th>Variance (Rs.)</th>
<th>% Variance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Patient days costs</td>
<td>12,000</td>
<td>15,000</td>
<td>(3,000)</td>
<td>(25%)</td>
</tr>
<tr>
<td>Catering labour</td>
<td>7,500</td>
<td>10,000</td>
<td>(2,500)</td>
<td>(33.33%)</td>
</tr>
<tr>
<td>Supplies and provision</td>
<td>60,000</td>
<td>70,000</td>
<td>(10,000)</td>
<td>(16.67%)</td>
</tr>
<tr>
<td>Water</td>
<td>1,000</td>
<td>1,200</td>
<td>(200)</td>
<td>(20%)</td>
</tr>
<tr>
<td>Fuel</td>
<td>3,500</td>
<td>4,200</td>
<td>(700)</td>
<td>(20%)</td>
</tr>
<tr>
<td>Maintenance &amp; other services</td>
<td>2,000</td>
<td>2,700</td>
<td>(700)</td>
<td>(35%)</td>
</tr>
<tr>
<td>Catering-Manager’s Salary</td>
<td>9,000</td>
<td>9,300</td>
<td>(300)</td>
<td>(3.33%)</td>
</tr>
<tr>
<td>Depreciation</td>
<td>10,000</td>
<td>12,000</td>
<td>(2000)</td>
<td>(20%)</td>
</tr>
<tr>
<td>Allocated Administrative cost</td>
<td>3,000</td>
<td>3,750</td>
<td>(750)</td>
<td>(25%)</td>
</tr>
<tr>
<td></td>
<td>1,08,000</td>
<td>1,28,150</td>
<td>(20,150)</td>
<td>(17.86%)</td>
</tr>
</tbody>
</table>

The above report shows that most expenses are substantially above their budgeted levels and departmental heads should pay particular attention to cases where the volume of such expenses is large.

The annual budget for the year 19X1 prepared by the GM in consultation with the departmental heads was approved at the budget meeting. Quarterly budgets were prepared based on one-fourth of the annual budget. It was also observed that the price increases which were considered at the time of preparation of the budget were underestimated by about 3%.

**Required**

1) Comment on the budget of the responsibility centre manager.

2) Comment on the variances and explain what part of it, if any, can be assigned to the responsibility centre.

### 4.12 FURTHER READINGS


*Management Control systems-Cases and Readings*, Richard D. Irwin; Homewood,


Solution Question No. 7

1) The idea of controllability of expenses is of significant importance to the design of a responsibility accounting system. The quarter's budget fails to appreciate the fact that the catering manager has no control over the number of patients to be catered to. It should also be noted that some items of expenses, included in the responsibility report, are beyond the control of the catering manager. Items such as manager's salary, allocation administrative expenses, depreciation are outside the control of the catering manager.

Regarding the increase in cost, they have to be seen in the light of the seasonality of patient arrival. This can be taken care of by opting for a flexible budget. The GM had made a mistake by dividing the fixed budget into quarters without considering the volume changes during the quarters.

2) The variation should be identified in terms of expenses needing the manager's attention. In doing so, proper adjustments should be made for the change in volume of activity. The variances should be analysed to find out the causes of variances such as volume change, change in prices, excess use of resources, unexpected increase in work demanding overtime payments and so on.

The total variation from the budget, after taking the above factor into consideration and the pattern of variation over time, provide some of the necessary aspects for judging the efficiency and effectiveness of the manager.