

THE ROLE OF RESPONSIBILITY CENTERS IN THE OVERALL PERFORMANCE OF THE ENTITY

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Abstract

In a big, multi-productive company, spread upon a large geographical area, with advanced hierarchies and typical of modern business- a miniature economy, the managers must decide who inside the organization is responsible for making a certain decision and how this will be evaluated and rewarded.

The central objective information and organizational planning is that of creating a balance between benefits and costs in making the decision, by a decentralized system.

Keywords: *cost- bearer, expense departments, responsibility centre, efficiency, efficaciousness, cost centers, centers for discretionary expenses, turnover centers, profit centers, responsibility centers.*

1. INTRODUCTION

In organizing accountancy and cost calculation, the choice of expense departments and of cost- bearers is vital for the monitoring and collecting the costs, on one hand, and for the fulfillment of the established aims, on the other.

The cost- bearer may be defined as a production unit or a service the costs refer to. For instance, production units, namely cost- bearers, could be: an order, a tonne of finite product, a decalitre of beer. Service units: the distance in kilometers, kilowatts/ hour, the time of consultation etc.

By *expense departments* (also known as places, centers or areas of expense/ cost) we understand "the subdivisions of the technical-productive, managerial and administrative frames of the enterprise in relation with which there is organized the planning, programming and analytical monitoring of the expenses forming the production cost." (1)

In the evolution over the last ten years of the Romanian enterprises there is a more and more obvious tendency that the activity of their managers should be centred upon the

client and the change. This leads to the search of those management methods that could ensure the activity of the enterprises in conditions of competitiveness and profitability, which however implies organizational activities, able to allow the use, as easily as possible, of modern methods and techniques in organization and management.

In this context, *the structure of the enterprise's activity into responsibility centers* has become a priority in satisfying the clients' requirements and in fulfilling a profitable activity.

Arguments:

- the possibility of establishing responsibility for the expenses;
- the monitoring and accurate founding of expenses even on the original spots;
- the delimitation of expenses that do not strictly depend on the production activity from those strictly connected to this process;
- the establishment of deviations from the pre-established levels of these expenses;
- the establishment of a system of rules that would allow the emphasis on each agent's responsibilities;
- the introduction of a system of allotment of resources and of monitoring their use, by establishing expense budgets specific for each responsibility centre.

2. THE REQUIREMENTS OF DIVIDING INTO RESPONSIBILITY CENTERS

The division of the enterprise activity into responsibility centers must take into consideration the following requirements:

- a. it must rely on the existing organization within the enterprise and must be updated only when sharing responsibilities must change;
- b. within responsibility centers there must be included all the enterprise's fields of activity, without a superimposition of activities performed in several different responsibility centers;
- c. a responsibility centre cannot be managed by more than one person in charge.

The problem of division into responsibility centers is not a serious one in small enterprises, where the owner is the main decision-maker. In this case the enterprise has one responsibility centre whose performances will be analysed with the help of the factors of profit and profitableness.

In big and medium enterprises, the activity is structured into responsibility centers on several hierarchical levels, so that the general budget of the enterprise will be divided into corresponding sub-budgets for each responsibility centre.

A responsibility centre represents a division of the enterprise with the following characteristics:

- ✚ it is placed under the authority of a person in charge;
- ✚ it carries out one or more missions with well established quantitative and value objectives;
- ✚ it possesses a set of resources necessary to fulfill the pre-established aims;
- ✚ it has a certain relative autonomy within the resource budget.

Keeping a responsibility centre under control consists of:

- determining and evaluating the objectives;
- foreseeing and evaluating the necessary consumption to reach the objectives;
- controlling its efficiency and efficaciousness.

Efficaciousness represents the relationship between the production and its objectives. It is said that a responsibility centre had an efficacious activity when it reached the pre-established objectives.

Efficiency is a relation between the effects and the effort performed by the responsibility centre. It is said that a centre is efficient if it consumes few resources for a specific given amount of production and if it produces more for an identical consumption of resources.

The efficiency of an administration of the enterprise is measured by comparing the real costs with the standard ones. In this situation, a responsibility centre may be efficacious but can not be efficient. It is the situation of that centre which reaches its production objectives but consumes more resources than the consumption norms established.

In this context in an enterprise we can find the following sub-budgets:

- the budget of products or takings;
- the budget of expenses;
- the budget of margins.

It is obvious that enterprises do not always come into direct contact with their surroundings, that is why they do not have a turnover in the sense of accountancy. In such cases there must be established separate responsibility centers, considering the fact that the centers will not possess a budget structured in the form presented above.

3. RESPONSIBILITY CENTERS: DEFINITION, CLASSIFICATION, FEATURES AND OBJECTIVES

The activity of an entity can be structured into units independent from a budgetary point of view, also called responsibility centers.

The responsibility centre may be defined as "a set of elements dependent on each other, which form an organized whole, having a degree of autonomy in the use and optimization of the resources they possess". (2)

Responsibility centers include:

✚ the revenue centre represents the organizational link in which the activity is appreciated as value according to the revenue acquired, such as the sales department within an organization. The revenue is planned on the basis of the accomplishments in the previous year and of their anticipation for the year on course. The management periodically analyses the revenue budget and that of anticipation, and intervenes in the case of deviations.

✚ the cost centre represents the organizational link in which products/ services are obtained which generate expenses (costs) with the help of which there can be measured the efficiency and efficaciousness of the centers' activity.

The cost centers are "subdivisions of the technical - productive, organizational and administrative frame of the enterprise in relation with which there is organized the analytical programming and monitoring of the production expenses."

The cost centre may be an enterprise, a department, a section, a functional service which collects indirect expenses. This one may be also organized at a workplace, if expense budgets can be elaborated.

✚ the profit centre is the operational subdivision which performs its activity by attracting resources which generate revenue.

The profit centre is the organizational centre within which profit can be calculated.

Within profit centers there are produced subsystems, finite products or there are executed services which are sold outside and for which a selling price is calculated.

If deviations appear, especially by not accomplishing the proposed profit, there are identified the causes which led to this situation and measures are taken to improve the situation.

✚ the investment centre is the organizational link in which there can be emphasized the relationship/ difference between the revenue obtained from product sales and the investment made for all the resources necessary in production.

The advantages of responsibility centers are as follows:

- they facilitate the control of some financial factors by specialists in budgets who do not need to know technological details;
- they allow identification of the contribution from each responsibility centre towards the entity's profit.

The responsibility centre has the following **characteristics**:

- it has a well-defined type of activity through its statute or its founding contract, having competences in keeping, developing, replacing and reducing the assets;
- it administers an asset;
- it has an organizational, functional and productive structure, with competence in defining it;
- it plans and changes its own set of rules for organization and functioning;
- it has its own tasks in production;
- it devises its own expense budget;
- it evaluates and administers its own budget resources;
- it emphasizes its own financial results;
- it devises monthly accounting balances or, if necessary, the final balance;
- it emphasizes its own savings and/ or profit;
- it takes responsibility for the results obtained;
- it is not responsible for the unprofitable activities of other centers within the entity;
- it cooperates with other centers to accomplish activities by signing collaborative conventions;
- it uses its resources to get performance;

- it may attract partners but it does not have competence in signing economic agreements;
- it has a manager who is responsible for the performances of the responsibility centre.

The activity of a responsibility centre is established by its statute or its founding contract, after analysis, studies and decisions concerning its organizational structure.

Following the diagnosis analysis, responsibility centers may be constituted:

- on production activity (manufacturing a product, a range of products or reference marks);
- on technological processes;
- on a field of activity (planning, information services etc.);
- on auxiliary activities (repairs, utilities, analysis etc.).

Responsibility centers are established inside basic, auxiliary, servicing and functional departments.

According to the field of activity established by the statute or by the founding contract there can be defined the activity of each centre which may be the initial one or it may be developed by including other activities as well, or it may be replaced, in relation with the market and the future. These operations are performed while accomplishing and integrating them with the entity's strategic mission and objectives.

Within each responsibility centre there is devised the expense budget, there are monitored deviations from the planned budget in an operative way and corrective measures are taken.

The responsibility centre is a complex structure which can settle its own multiple *objectives*, according to the strategy of the organization it is part of, as follows:

- devising its own programmed activities (satisfying the needs of the clients, respecting the delivery deadlines, promoting creativity etc.);
- optimizing the way of using the resources for the improvement of the entity's global performance and that of the responsibility centre;
- establishing the systems of evaluation and control of performance (financial, operational, personnel, management, marketing etc.);
- establishing valid procedures of devising the expense budgets corresponding to the responsibility centre with the possibility of integrating and emphasizing within the general budget of the entity, separating and allotting expenses for fix and variable costs;
- simplifying the system of emphasizing the procedures for communication, reporting and cooperation, amplifying the operating speed by installing information procedures;
- introducing and perfecting procedures for financial - accountancy balance;
- increasing the capacity to adjust production to the requirements of the clients in terms of quality;
- changing the employees' mentality in the sense of increasing awareness of the need for them to be active, participatory, efficient.

4. TYPES OF RESPONSIBILITY CENTERS

In specialized books, responsibility centers classify in the following categories:

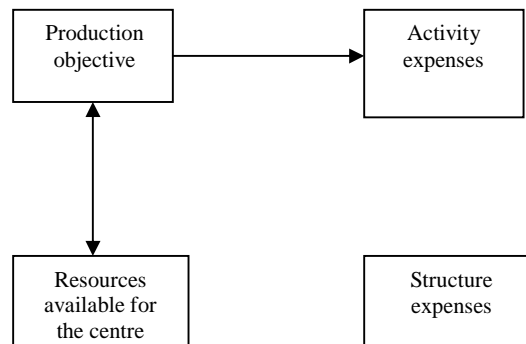
- cost centers;
- discretionary expense centers;
- turnover centers (revenue centers);
- profit centers;
- profitability centers.

Cost centers (standard) are typical for production departments or workshops.

The objective of the department or workshop manager consists of the production of an amount of products with minimum consumption of material or human resources. In practice, the consumption norms are established by the technical departments in the form of consumption standards, and the objective of the department or workshop manager consists of minimizing the deviations between the real and standard costs.

In such a centre, efficiency and efficaciousness are expressed in measurable factors. The process of devising the set of expenses for the cost centers is presented in figure 1.

Figure no. 1. The process of devising the set of expenses for the cost centers



Discretionary expense centers

Discretionary expenses are those expenses which can not be established according to a planning of the production activity.

These expense centers are characterized by the fact that the result of their activity is not directly measurable. In such centers it is difficult to have a separation of variable expenses from those related to the structure. That is why all the expenses of such a centre will be considered as structural expenses.

These centers are called “discretionary expense” centers due to the fact that their budget is established on the basis of the experience of the people in charge: their objective consists of executing high quality services while sticking to a pre-established budget.

It is important to note the fact that the services of these centers can not be measured directly.

This leads to the idea that the budget of discretionary expense centers represents a budget of authorizing expenses or, in other words, it is a budget of administration.

The expenses of these centers are available to the people in charge with them, and the way of monitoring the use of the budgets is as follows:

- limiting to the maximum the number of responsibility centers within functional services;
- monitoring the tendency to increase the level of these centers’ expenses.

It must be mentioned the fact that efficiency and efficaciousness are not measurable in the case of centers whose people in charge has no authority over the level of prices, but which must respect the fees established by the management.

Also, the person in charge with these centers has no control over the distribution expenses. Under such circumstances, the person in charge must limit to the budget allotted to increase the level of sales as much as possible.

Turnover centers (revenue centers) are created with the purpose of organizing marketing and distribution activities.

If the turnover centre is also credited to establish the sale price, then it can be responsible for the revenue it generates.

If the policy concerning prices is determined outside the centre, the manager is only responsible for the amount and structure of sales.

When measurement of performance is chosen for a turnover centre, there must also be included the notion of cost of the product, so that the centre is motivated to maximize the rough margin, not only the revenue from sales.

If there is evaluated only the revenue from sales, the managers will be stimulated to reduce the prices to increase the sales, to spend excessively on publicity or to promote the products for

reduced profits. Each of these actions may increase the total sales, but will decrease the overall profitability of the company.

Profit centers are centers whose people in charge must find the best connections between costs and takings.

This situation can be best found with a production line or a shop selling finite products at a pre-established production cost (standard costs) which is responsible for the profit resulting from the activity performed in the centre; the profit thus gained is measurable in terms of "margin" which is defined as a difference between the turnover, on one hand, and the sum of production costs of the products sold and the distribution expenses, on the other.

Profitability centers (investment centers) are centers whose responsibility is oriented towards the assets used.

Profitability centers represent a variant of profit centers in a more elaborate form.

Thus, profitability centers are profit centers whose person in charge has an objective of profitability depending not only on sales but also on the capital used. In reality there can be considered two different levels of profitability centers:

- The level which actively takes part in the choice of the type of investment and whose objective is expressed in the form of a ratio:

$$\frac{\text{Result (or margin) of the centre}}{\text{Gross fix means+ the needs of the center's circulating funds}}$$

- The level of departments responsible with the administration of circulating assets, whose objective is represented as such:

$$\frac{\text{Margin of the centre}}{\text{The needs of the centers circulating funds}}$$

The scheme of the synthesis of different types of responsibility centers can be represented as follows:

Table no. 1 the synthesis of different types of responsibility centers

Centre type	Examples	Responsibility	Objective
Discretionary expense centers	Administrative services	Using the budgets to obtain the best services (not measurable directly)	No profit objectives
Turnover centers	Sales departments	Sticking to the objective of the turnover or maximising the amount of sales	No profit objectives
Profit centers	Production units	Minimising deviations between consumption done and consumption proposed	Maximising profit
Profitability centers	Some production units	Maximising the overall result by making the best correlation between costs and turnover. Maximising profitability of the capital used.	Capital profitability

5. INFLUENTIAL FACTORS UPON THE ACTIVITY OF RESPONSIBILITY CENTERS

The main factors that influence the activity of responsibility centers are:

- *the owner*: influences the strategy and the objectives of the organization and, implicitly, of the responsibility centers. He/ she influences the amount of resources.

- *the general management of the company*: establishes the strategy and the objectives of the organization leading to the objectives of the centre. They negotiate the system of rewards and the control procedures.

➤ *the size and complexity of the enterprise*: influences by the amount of resources of the enterprise, according to which the budget can be established and the number of centers. It influences the acceptance or refusal of the change represented by the reorganization of the activity in responsibility centers,.

➤ *the technical endowment*: performance; sticking to the budget.

➤ *the human resources*: professional training, age, motivation, working capacity.

➤ *the economic-financial status*: the amount of funds on the level of each centre; success in business; the strategy of responsibility centers.

➤ *the culture and behaviour of the enterprise*: the behaviour norms of the employees; measuring performance and establishing rewards.

The main characteristics of a responsibility centre are:

✚ *self-stabilization*- the characteristic of the centre to maintain itself in a specific state by adjusting to the changes that influence it;

✚ *self-organisation*- the characteristic of the centre to create stable structures for new situations.

6. THE ROLE OF RESPONSIBILITY CENTERS

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The central objective information and organizational planning is that of creating a balance between benefits and costs in making the decision, by a decentralized system.

Alfred Chandler, in his studies on the development of the American industrial enterprises, presented in a very expressive way his request for decentralization of the organizations, supporting this process with the role of responsibility centers, mainly including the following:

➤ permanently monitoring the key variables of the external medium in which the company operates so it can take action before the external events take place;

➤ much easier identification of market opportunities, of possibilities and constraints related to production, of conceptions and possibilities of the workforce, of the quality and feasibility of the goods and services provided by the local suppliers;

➤ diminishing the time of reaction in making decisions under unexpected circumstances;

➤ increasing the time for central management to make long-term strategic decisions which are vital for the company;

establishing general instructions by the central management, when the managers of responsibility centers keep the liberty of making decisions related to the centers' activity, overlapping the overall objectives of the company.

NOTES:

(1) Oprea Calin, Gheorghe Carstea, *Contabilitate de gestiune si calculatia costurilor*, Editura Genicod, 2000, pag. 68;

(2) Costache Rusu, Monica Voicu, *Managementul pe baza centrelor de responsabilitate*, Editura Economica, Bucuresti, 2001, page 15;

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