|  |
| --- |
| Chapter 22 Outline1. **Responsibility Accounting**
2. Performance Evaluation
3. Large companies are easier to manage if divided into smaller units called *divisions*, *segments*, or *departments*.
4. In **decentralized** **organizations**, unit managers make decisions and top management evaluates their performance.
5. **Responsibility** **accounting** evaluates unit managers only on activities they can control.
6. The methods of performance evaluation vary for cost centers, profit centers and investment centers.
7. Cost center⎯incurs costs without generating revenues (e.g. manufacturing departments and service departments).
8. Profit center⎯incurs costs and generates revenues (e.g. product lines).
9. Investment center⎯incurs costs, generates revenues and its managers is responsible for major investing decisions.
10. Basis for evaluating performance:
11. Cost center managers are evaluated on their success in controlling actual costs compared to budgeted costs.
12. Profit center managers are evaluated on their success in generating income.
13. Investment center managers are evaluated on their use of assets to generate income.
14. **Controllable versus Uncontrollable Costs**
15. Controllable Costs -
16. Costs a manager can determine or influence.
17. Uncontrollable costs –
	1. Costs not within the manager’s control or influence.
18. A manager’s performance is evaluated using responsibility accounting performance reports that list actual costs that a manager is responsible for and their budgeted amounts.
19. Distinguishing between controllable and uncontrollable costs depends on the particular manager and the time period under analysis.
20. All costs are controllable at some level of management if the time period is sufficiently long.
 |
| 1. Responsibility Accounting Performance Report
2. Reports actual costs that a manager is responsible for and their budgeted amounts.
3. Analysis of differences between actual and budgeted amounts often results in corrective or strategic managerial actions.
4. Recognizes that control over costs and expenses belongs to several layers of management.
5. Provides relevant information for each management level.
6. Lower-level managers have responsibility for more detailed costs.
7. Higher-level managers are responsible for larger and broader costs.
8. Reports to higher-level managers usually are less detailed because lower-level managers are responsible for detailed costs and detailed reports can distract from key issues facing top managers.
9. **Profit Centers**
10. The responsibility accounting focuses on how well each department-controlled costs and generated revenues.
11. **Departmental** **income** **statements** are used to report profit center performance.
12. When computing department income, we make two decisions for allocating expenses:
	1. How to allocate indirect expenses, such as rent and utilities which benefit several departments.
	2. How to allocate service department expenses, such as payroll and purchasing, that benefit several departments.
13. Expenses
14. *Direct expenses* are readily traced to a department.
15. Incurred for sole benefit of that one department; no allocation required.
16. Often, but not always, controllable costs.
17. *Indirect expenses* are incurred for joint benefit of more than one department; can’t be readily traced to just one department.
18. Allocated across departments benefiting from them.
19. Ideally allocated to departments that benefit from them.
20. Expense Allocations – indirect expenses and service department expenses are allocated to departments that benefit from them.
	1. Allocated Cost = Total cost to allocate x Percentage of allocation base used.
21. Allocating Indirect Expenses – no standard rule for “best” allocation bases exists. Commonly used allocation bases for allocating indirect expenses include:
	* + 1. Wages and salaries –hours worked in each department.
22. Rent and utilities⎯floor space occupied.
23. Advertising –percentage of total sales.
24. Depreciation –hours of depreciable asset used.
25. Service Department expenses –operating departments use services such as personnel, payroll and purchasing. Commonly used allocation bases for service expenses:
	1. Office -- number of employees or sales in each department.
	2. Personnel and payroll -- number of employees in each department.
	3. Purchasing– dollars of purchases or number of purchase orders processed.
	4. Maintenance– square feet of space occupied.
26. Departmental Income Statements
27. Departmental income is computed using the following formula: Departmental income = Dept. sales – Dept. direct expenses – Allocated indirect expenses – Allocated service dept. expenses.
28. Three steps for allocating costs and preparing departmental income statements:
	* + - 1. Step 1: accumulate sales, direct and indirect expenses by department. List sales and amounts for each department followed by the same for direct expenses and indirect expenses. Total for each expense is in the Expense Balance column. Exhibit 22.9 shows these data.
 |
| * 1. Direct and indirect expenses include salaries, depreciation and supplies expenses.
1. Step 2 – allocate indirect expenses to both service and operating departments.
	1. Uses a departmental expense allocation spreadsheet shown in Exhibit 22.10.
	2. Calculations are shown for the allocation of Rent and Advertising.
2. Step 3—allocate service department expenses to operating departments. After service department costs are allocated, no expenses remain in service departments.
3. Prepare departmental income statements using the departmental expense allocation spreadsheet.
	1. Actual service department expenses are compared with budgeted amounts to help assess cost center performance.
	2. Amounts in the operating department columns are used to prepare departmental income statements. (Exhibit 22.11).
 |
| 1. Departmental Contribution to Overhead (see Exhibit 22.12)
2. Departmental income statements not always best for evaluating each profit center’s performance especially when indirect expenses are a large portion of total expenses.
3. Evaluate using departmental contributions to overhead⎯a report of the amount of sales minus cost of goods sold and direct expenses.
4. **Investment Centers**
	1. Financial Performance Evaluation Measures include:
	2. Return-on-investment (return on assets), computed as income divided by average assets.
	3. Residual income – Expressed in dollars. Encourages division managers to accept opportunities that return more than target income. Computed as income minus target income.
	4. Profit margin and investment turnover – split return on investment into two measures – profit margin and investment turnover.
		* + 1. Profit margin measures income per dollar of sales computed as income divided by sales. Shown as a percent.
				2. Investment turnover measures how efficiently an investment center generates sales from its assets. Calculated as sales divided by average assets. Expressed as the number of times assets were converted into sales.
5. Evaluating performance solely on financial measures has limitations. Companies can also use nonfinancial measures.
6. **Balanced scorecard**: system of performance measures, including nonfinancial measures used to assess company and division manager performance. Requires managers to think of their company from four perspectives:

 Customer: What do customers think of us? Internal Processes: Which operations are crucial to customers?Innovation/Learning: How can we improve?Financial: What do our owners think of us?1. **Transfer Pricing**

The price used to record transfers across divisions within a company is called a transfer price. Can be used in cost, profit and investment centers. 1. Low transfer price – transfer price cannot be less than variable manufacturing cost.
2. High transfer price – transfer price cannot be more than the market price.
3. The transfer price should be between the low and high transfer price.
4. If there is no excess capacity, the internal supplier will not accept a transfer price less than the market price. This is called the **market-based transfer price**.
5. If there is excess capacity, the internal supplier should accept a price between the variable cost and the market price. This is called the **cost-based transfer price**.
6. If there is excess capacity, division managers often negotiate a transfer price between the variable cost per unit and market price per unit. This is called the **negotiated transfer price**.
7. **Decision Analysis Cash Conversion Cycle**
8. Effectively managing working capital is important for survival and profit.
9. Accounts receivable, accounts payable, and inventory ratios are used to evaluate performance on working capital dimensions.
	1. Combining these ratios summarize how a company manages its working capital.
10. The cash conversion (or cash-to-cash) cycle measures the average time it takes to convert cash outflows into cash inflows.Cycle conversion cycle = Days’ sales in accounts receivable plus Days’ sales in inventory minus Days’sales in accounts payable.
	1. If a company’s conversion cycle is too long, companies do not have use of that money and risks missing investment opportunities.
	2. Companies can speed up the cash conversion cycle by:
		1. Offering customers fewer days to pay
		2. Offering customers discounts for prompt payment
		3. Adopting lean principles to reduce inventory
		4. Negotiating longer times to pay suppliers
11. **Appendix 22A – Joint Costs**
12. Joint Costs⎯the costs incurred to produce or purchase two or more products at the same time.
13. When management wishes to estimate the costs of individual products, joint costs must be allocated to joint products.
14. Financial statements prepared according to GAAP also must assign joint costs to products.
15. Popular approach is the value basis which allocates joint cost in proportion to the sales value of the output produced by the process at the split-off point.
16. Split-off point is the point at which separate products can be identified.
17. Value basis of allocation of joint costs:
	1. Shown in Exhibit 22A.2.
	2. Determine the percents of the total costs allocated to each product by the ratio of each product’s sales value at the split-off point to the total sales value.
	3. Allocation basis is a close matching of costs and revenues.
 |
|  |