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Topic : RESPONSIBILITY ACCOUNTING

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Responsibility Accounting

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ABSTRACT

The systems of costing like standard costing and budgetary control are useful to management for controlling the costs. In those systems the emphasis is on the devices of control and not on those who use such devices. Responsibility accounting is a system of control where responsibility is assigned for the control of costs. Responsibility accounting focuses attention on responsibility centers. A responsibility centre is a sub-unit of an organization under the supervision of a manager who has the responsibility for the activities of that responsibility centre. Each sub-unit has certain activities to perform and its manager is assigned the responsibility and/or authority to carry out those activities. Reports are prepared to inform a responsibility centre manager how well he has performed in terms of costs. The purpose is not to indicate failure or to find fault. To be effective, control must be conceived as a means of locating those activities and people in the organization in need of help so that assistance can be rendered and the scarce resources of the firm more effectively utilized.

KEYWORDS: Responsibility Accounting, Responsibility Centre, Transfer Prices

1. INTRODUCTION:

The systems of costing like standard costing and budgetary control are useful to management for controlling the costs. In those systems the emphasis is on the devices of control and not on those who use such devices. Responsibility accounting is a system of control where responsibility is assigned for the control of costs. The persons are made responsible for the control of costs. Responsibility accounting implies a system of accounting whereby the performance of various people is judged by assessing how far they have achieved the predetermined targets set for the divisions, departments or sections for which they are responsible. Each person is responsible for his area of operation.

Responsibility accounting is similar to any other system of cost such as standard costing or budgetary control but with greater emphasis towards fixing of the responsibility of the persons entrusted with the execution of specific job. For example, if Mr. X has prepared the cost budget of his department, he will be made responsible for keeping the costs under control. Mr. X will be supplied with detailed information of actual costs incurred by his department. In case the costs are more than budgeted costs, then A will try to find out the reasons and take corrective measures. X will be personally responsible for the performance of his department.
2. DEFINITION OF RESPONSIBILITY ACCOUNTING:

Responsibility accounting is a system under which managers are given decision-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 or divisions.

Eric Kohier defines responsibility accounting as “a method of accounting in which costs are identified with persons assumed to be capable of controlling them, rather than with products or functions. It differs from activity accounting, in that it does not in itself require an organizational grouping by activities and sub-activities or provide a systematic criterion of system design.”

Charles T. Horngreen defines “Responsibility accounting is a system of accounting that recognizes various responsibility centers throughout the organization and reflects the plans and actions of each of these centers by assigning particular revenues and costs to the one having the pertinent responsibility. It is also called profitability accounting and activity accounting”.

The following inferences can be made from the above definitions:

1. Responsibility accounting stresses on communication of information in general and accounting information in particular to various decisional centers.
2. Responsibility accounting lays greater emphasis on persons (human Factor management)
3. Responsibility accounting is tailored to the organizational structure so that the process of communication of information follows principles of organization.
4. It is an accounting system which collects and report both planned and actual accounting data in terms of sub-units which are recognized as responsibility centers.

3. STEPS INVOLVED IN RESPONSIBILITY ACCOUNTING:

Responsibility accounting is used as a control device. Following steps are necessary to effect control through the responsibility accounting:

1. The organization is divided into various responsibility centers. Each responsibility centre is put under the charge of a responsibility manager.
2. The targets or budgets of each responsibility centre are set in consultation with the manager of responsibility centre so that he may be able to give full information about his department. The manager of responsibility centre should know as what is expected of him – each centre should have a clear set of goals. The responsibility and authority of each centre should be well defined.
3. Managers are charged with the items and responsibility over which they can exercise a significant degree of direct control.
4. Goals defined for each area of responsibility should be attainable with efficient and effective performance.
5. The actual performance is communicated to the managers concerned. If it falls short of the standards, the variances are conveyed to the top management. The names of persons responsible for the variances are also conveyed so that responsibility may be fixed.
6. The performance reports for each centre should be prepared highlighting the variances and items requiring managements attention. The corrective measures are suggested or taken and communicated to the concerned managers of the centers.
4. RESPONSIBILITY CENTERS:

Responsibility accounting focuses attention on responsibility centers. A responsibility centre is a sub-unit of an organization under the supervision of a manager who has the responsibility for the activities of that responsibility centre. Each sub-unit has certain activities to perform and its manager is assigned the responsibility and/or authority to carry out those activities. Responsibility centre is the segment of business with reference to which information will be communicated to pinpoint responsibilities.

➢ EXPENSE CENTRE:

An expense centre is a responsibility centre in which inputs, but not outputs, are measured in monetary terms. Expense or cost centre is a segment of an organization in which the managers are held responsible for the costs incurred in that segment. Responsibility accounting is based on financial information relating to input (costs) and outputs (Revenues). In an expense centre of responsibility, the accounting system records only the cost incurred in/by the centre or unit but revenues earned (output) are excluded. In case of certain responsibility centres, it is neither possible nor necessary to measure the output in terms of monetary units. Most of the service departments come in this category.

➢ 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 expenses of the marketing department. The performance of a revenue centre is evaluated by comparing the actual revenue with budgeted revenue. The marketing manager of a product line, or an individual sales representative are example of revenue centers.

➢ PROFIT CENTRE:

A responsibility centre is called a profit centre when the manager is held responsible for both costs (inputs) and revenues (outputs) and thus for profit. A profit centre is a big segment of activity for which both revenues and costs are accumulated. A centre whose performance is measured in terms of both – the expense it incurs and revenue it earns, is termed as a profit centre. The output of a responsibility centre may either be meant for internal consumption or for outside customers. In the latter case the revenue is realized when the sales are made.

➢ INVESTMENT CENTRE:

It is defined as a responsibility centre in which inputs are measured in terms of cost/expenses and outputs are measured in terms of revenues and in which assets employed are also measured. A responsibility centre is called an investment centre, when its manager is responsible for costs and revenues as well as for the investment in assets used by his centre. He is responsible for maintaining a satisfactory return on investment i.e. revenues, expenses and the amounts invested in the center's assets. The manager of an investment centre is required to earn a satisfactory return. Thus, return on investment (ROI) is used as the performance evaluation criterion in an investment centre.
5. ADVANTAGES OF RESPONSIBILITY ACCOUNTING:

The following are some of the advantages of responsibility accounting:

1. It introduces a sound system of control — a system of closer control.
2. Each and every individual in the organization is assigned some responsibility and they are accountable for their work.
3. Everybody knows what is expected of him. Nobody can shift responsibility to anybody else if something goes wrong.
4. It is an effective tool of cost control and cost reduction applied with budgetary control and standard costing.
5. It facilitates the management to set realistic plans and budgets.
6. It is not only a control device but also facilitates decentralization of decision-making.
7. It measures the performance of individuals in an objective manner.
8. It fosters a sense of cost-consciousness among managers and their subordinates.
9. It helps the management to make an effective delegation of authority and required responsibility as well.
10. Under the system of responsibility accounting, detailed information is collected about costs and revenues, on a continuous basis and the data is helpful in planning for future costs and revenues.
11. Timely corrective action can be taken and better control over costs can be achieved.

6. COST CENTERS VS. RESPONSIBILITY CENTERS:

A cost center is “a location, person or item of equipment (or group of these) for which costs may be ascertained and used for purposes of cost control”. Thus, cost center is used as a means of assembling items of cost, so that they can be assigned to goods and services. In the case of cost centre, emphasis is not on the persons who may be managing a level or product or process. Responsibility centers, on the other hand, are established on the basis of responsibility delegated to responsible personnel of the organization with a view to identify costs which can be controlled by each one of them. However, cost centers sometimes may be used as responsibility centers too. In that case cost reports are prepared both cost centre-wise and responsibility-centre-wise.

7. TRANSFER PRICES IN RESPONSIBILITY ACCOUNTING

The measurement of profit in a profit centre type of responsibility accounting is also complicated by the problem of transfer prices. A transfer price is a price used to measure the value of goods/services furnished by a profit centre to other responsibility center within a company. That is, when internal exchange of goods and services take place between the different divisions of a firm, they have to be expressed in monetary terms. The monetary amount for these inter-divisional exchanges/transfers is called the transfer price. While determining transfer prices a number of criteria should be carefully considered:

1. Transfer prices should help in the accurate measurement of divisional performance (profitability) measurement.
2. Transfer prices should motivate the divisional managers into maximizing the profitability of their divisions and making decisions that are in the best interest of the organization as a whole.
3. Transfer prices should ensure that divisional autonomy and authority is preserved.
4. Transfer prices should allow goal congruence to take place, which in effect means that the objectives of divisional managers are compatible with the objectives of overall company.
Transfer price policies refer to the selection of policies/methods that would govern the calculations of such prices under various circumstances. The concern of transfer price policies is with developing a transfer pricing system that (i) allows a measure of performance to reflect the use of resources by a division, and (ii) allows the optimal allocation of the firm's resources. In other words, suitable transfer prices should be related to (a) management performance assessment, and (b) decision-optimization.

Chiefly there are two methods of transfer pricing – cost based and market based. Based or these, there are many types of transfer pricing – cost price, marginal cost price, standard cost price, cost plus fixed margin, market price, negotiated price, opportunity cost price etc. Each type of transfer pricing have advantages and disadvantages too.

8. COST CONTROL THROUGH RESPONSIBILITY ACCOUNTING:

The essence of responsibility accounting, as discussed above, is the collection of costs according to responsibility centers in order that variances from standard costs and budgets can be identified with per sons, and based on the causes of variances, corrective actions may be initiated. Reports are prepared to inform a responsibility centre manager how well he has performed in terms of costs. The purpose is not to indicate failure or to find fault. To be effective, control must be conceived as a means of locating those activities and people in the organization in need of help so that assistance can be rendered and the scarce resources of the firm more effectively utilized. Controllable and Non-controllable Costs.

For each responsibility centre costs should be classified as controllable and non-controllable. Responsibility accounting is based on the notion that a responsibility centre manager should be held accountable for controllable costs. Since we have already discussed the concepts of controllable and non-controllable costs earlier. We focus on important points here.

9. CONCLUSION:

Responsibility accounting is similar to any other system of cost such as standard costing or budgetary control but with greater emphasis towards fixing of the responsibility of the persons entrusted with the execution of specific job. Responsibility accounting is a system under which managers are given decision-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 or divisions.

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Topic : SEGMENT REPORTING - AS A NEW AND GROWING CONCEPT OF ACCOUNTING STANDARD

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SEGMENT REPORTING - AS A NEW AND GROWING CONCEPT OF ACCOUNTING STANDARD

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ABSTRACT
In today’s competitive market a businessman does not deal in any particular product or market but it want to serve in multiple products / services and operates in different geographical areas. So it can cover wide area and face cut-thought competition when a business firm function in multiple products / service and in different market it need to properly anticipate and analyze risks and opportunities. All these information must be recorded in proper reports, which is known as segment reporting. The main aim of segment reporting is to properly identify & analyze business opportunities and risks. For the fulfillment of basic need of business reporting institute of charters accountant of India gives status as accounting standard. Accounting as a language of business communicates the financial results of an enterprise to various interested parties by means of financial statements which exhibit a 'True & Fair' picture of it’s state of affairs. A business firm deals with various transaction with various persons so it need to follow proper standards which everyone know any understand it. For that ICAI provides accounting standards. These accounting standards are written documents, statements and guidelines relating to all business transactions like establishment, reorganization, measurement, analyzes of all business transactions. Accounting standards are use as one of the main compulsory regulatory mechanisms for preparation and external audit of general – purpose of financial reports in all countries in the world. Today business operations are not up to boundaries of a one country but it cross the boundaries of one country and function globally / internationally. For that business does not fulfill all standards of one country but they has to fulfill all standards of different countries in which it function. There is always big conflict arise in applicability of internationalized accounting standards should all enterprises large or small in all countries of a given economy subject to the same standards? Similarly, should highly develops countries be subject to the same accounting standards as less develops or developing countries? So for all these questions internationalization of accounting standards is best solution among all conflicts. If business firm follows all internationalization accounting standard it can anticipate business opportunities and harmonize its business transactions with other economy transactions. So for the achievement of overall business goals and to reduce government interaction each & every business firm needs proper system of reporting transaction with well define accounting standards.

KEYWORDS: Segment Reporting, Business Segment, Geographical Segment
INTRODUCTION

Accounting standards 17, 'Segment Reporting', issued by the council of the Institute of chartered Accountants of India. This standard comes into effect in respect of accounting periods commencing on or after 1.4.2001 and is mandatory in nature, from that date, in respect of the following:

(i) Enterprises whose equity or debt securities are listed on a recognized stock exchange in India and enterprises that are in the process of issuing equity or debt securities that will be listed on a recognized stock exchange in India as evidenced by the board of director’s resolution in this regard.

(ii) All other commercial, industrial and business reporting enterprises, whose turnover for the accounting period exceeds Rs. 50 crores.

APPLICABILITY OF ACCOUNTING STANDARD

Applicable to Level I Enterprises. Not applicable to Level II and Level III enterprises in their entirely.

➢ List of Level I Enterprises:

1. Enterprises whose equity or debt securities are listed whether in India or outside India.
2. Enterprises which are in the process of listing their equity or debt securities as evidenced by the Board resolution in this regard.
3. Banks including co-operative banks.
4. Financial institutions
5. Enterprises carrying insurance business
6. Enterprises whose turnover exceeds Rs. 50 crores.
7. Enterprises having borrowings in excess of Rs. 10 crores at any time during the accounting period.
8. Holding companies and subsidiaries of enterprises falling under any one of the categories mentioned above.

➢ List of Level II Enterprises:

1. Enterprises whose turnover exceeds Rs. 40 lakhs but does not exceed Rs. 50 crores.
2. Enterprises having borrowings in excess of Rs. 1 crore but not in excess of Rs. 10 crores at any time during the accounting period.
3. Holding companies and subsidiaries of enterprises falling under any one of the categories mentioned above.

➢ List of Level III Enterprises:

Enterprises which are not covered under Level I, and Level II.

BENEFIT OF AS-17

Allocation of Resources:

Segment information, it disclosed to parties outside the enterprise, would play an important role in improving the allocation of scarce resources in an economy. The disclosure of information removes the imperfection in the investment market and causes the market to function properly.
INVESTMENT AND CREDIT DECISIONS

It is widely recognized by authors in accounting and finance, accountants and accounting bodies that segment information has great usefulness in investment and credit decisions. Segment information enhances investor's ability to understand a diversified company and to make accurate and useful forecast about the profitability of segments as well as the company as a whole.

EQUILIBRIUM IN SHARE PRICES

The segment disclosures would tend to adjust the prices of company shares according to information released.

TRUE AND FAIR VIEW

An important provision of the companies Act in India is to reveal a true and fair view of the results of operation and financial position. Segment disclosures may be greatly required in terms of the "true and fair" criterion established in the companies Act.

1) KEY DEFINITIONS:

- **Business Segment:**
  A business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products or services and that is subject to risks and returns that are different from those of other business segment. Factors that should be considered in determining whether products or services are related include:
  - The nature of the product or services,
  - The nature of the production process,
  - The type or class of customers for the product or services
  - The methods used to distribute the products or provide the services, and
  - It applicable, the nature of the regulatory environment, for example, banking, insurance or public utilities.

- **Geographical Segment:**
  A geographical segment is a distinguishable component of an enterprise that is engaged in providing products or services within a particular economic environment and that is subject to risks and returns that are different from those of components operating in other economic environments. Factors that should be considered in identifying geographical segments include:
  - Similarity of economic and political conditions,
  - Relationships between operations in different geographical area,
  - Proximity of operation
  - Special risks associated with operations in a particular area;
  - Exchange control regulations, and
  - The underlying currency risks.

- **Reportable Segment:**
  A reportable segment is a business segment or a geographical segment identified on the basis of forgoing definitions for which segment information is required to be disclosed by this statement.

- **Enterprise Revenue:**
  Enterprise revenue from sales to external customers as reported in the statements of profit and loss.
Segment Revenue:
- Segment revenue is the aggregate of
  - The portion of enterprise revenue that is directly attributable to a segment.
  - The relevant portion of enterprise revenue that can be allocated on a reasonable basis to a segment, and
  - Revenue from transactions with other segments of the enterprise.

Segment Expenses:
- Segment expenses include the following:
  - The expenses resulting from the operating activities of a segment that is directly attributable to the segment.
  - The relevant portion of enterprise expenses that can be allocated and a reasonable basis to the segment.
  - It includes expenses relating to transactions with other segments of the enterprise.

  A segment expense does not include the following:
  - Extraordinary items as defined in As-5 revised
  - Interest expenses
  - Interest incurred on advances from other segments.
  - Loss on sale of investments.
  - Loss on write-off of bad debts.
  - Income-tax
  - General administration and Head office expenses
  - Other expenses at enterprise level

Segment Assets:
- Segments assets are those operating assets that are employed by a segment in its operating activities and that either are directly attributable to the segment or can be allocated to the segments on a reasonable basis.
- If the segments result of a segment includes interest or dividend income, its segments assets include the related receivable, loans, investments or other interest or dividend generating assets.
- Segment assets do not include income tax assets.
- Segment assets are determined after deducting related allowances / provisions that are reported as direct offsets in the balances sheet of the enterprise.

Segment Liabilities:
- Segment liabilities are those operating liabilities that either are directly attributable to the segment or can be allocated to the segments on a reasonable basis.
  - If the segment result of a segment includes interest expenses, its segment liabilities include the related interest – bearing liabilities.

Segment Result:
- Segment result is segment revenue less segment expenses.

2) LIMITATIONS OF SEGMENT REPORTING:

The segmental reporting is criticized due to the following factors.

- The as 17 requires common costs to be apportioned to various segments on what the company’s management believes is a reasonable basis. In practice, there can be many
categories of common costs the standard requires not to apportion such common costs if their apportionment is misleading. There is a small cause in making an artificial apportionment of such costs.

- It is very difficult to determine segment assets in the enterprise. Some assets are required for general purposes and are used by different segments. It is preferable to disclose them as a separate asset in the balance sheet of the concern and a footnote of this fact that several segments use these assets commonly may also be furnished.
- The segmental results are dependent on the transfer price fixed for inter segmental sales, which are always logically determined and established. The use of various transfer pricing methods will make the segmental information not comparable with similar disclosures by other enterprises.
- The standard requires disseminating the information about the segments, which may not be desirable from the view that divulgence of strategic information of the organization may be total and sometimes causing threat to survival of the enterprise.

3) DIFFICULTIES IN SEGMENT REPORTING

The difficulties involved in segment reporting are, truly speaking, and the problems of implementation. Some problems in implementing segment-reporting proposal are listed below:

- Basis of Segmentation:
  How a diversified company should be fractionalized for reporting purpose is a problem in segment reporting. Basically there are three questions involved in this vital problem. The greatest problem in segmenting a diversified enterprise lies in the fact that diversification may exist in different forms such as industry, product lines individuals products market and geographical areas.

- Allocation of Common Costs:
  Common costs for the purpose of preparing segments reports need to be apportioned between different products. In some cases, common costs are apportioned on a basis, which may be classified as reasonable and reliable. If common cost were apportioned on a basis, which does not reflect a rational relationship, the basis being totally unjustified would produce inaccurate and unreliable segment figures.

- Pricing of Inter-segment Transactions:
  The segments in a diversified company may or may not have substantial amounts of inter-segment transaction. A diversified company having disparate segments may have very few inter-segment transactions. The market price for pricing inters – segment transactions may be more useful for external users as it provides accurate revenue data based on the transactions approach and the realization concept.

- Degree of Integration in Segment Activities:
  A more significant argument against segmental reporting can be made where a firm is highly integrated. In the case of a vertically – integrated firm, the recognition of external market for intermediate goods may not always be warranted.

- Management Conservatism:
  Another argument is that, where there is no regulatory provision to disclose segmental reports, voluntary disclosures are likely to be perceived by managements to be beneficial only in certain instances, for example, where management believes that the company's attractiveness to investors will be enhanced and the costs of finance reduced.
4) SEGMENT DISCLOSURES IN INDIA

In Indian companies Act, 1956 has provision for disclosures of some segmental information in published annual reports such as sales, production, stocks, and purchases. Besides, information about licensed capacity and installed capacity for every product is also to be given in the annual reports. It has been found that many diversified Indian companies develop segment information of their managerial planning control and decision making such as income statements, sales or other gross revenue, cost of goods sold, gross margin on sales, segmented contribution margin, selling expenses, administrative expenses, segmented not profit before tax, segmented balance sheet.

Accounting Standard 17 is mandatory in respect of companies who are listed on the stock exchange or who are in process of issuing equity or debt securities and will be accordingly listed on the stock exchange in India. Therefore, Indian companies are giving segmental information in compliances with AS 17 Segment Reporting issued by ICAI.

5) CONCLUSION:

In today’s business world we need to record, analyze and report proper information about all day-to-day transaction. If we do not maintain all records properly so it is possible that we lost many opportunities so it is necessary that we should record all transactions and so we need proper system of “Business Reporting.” Business reporting provides valuable any vital market news, information and technical data relating to industry.

A report of recent business events such as business and environment, trade, technology, manufacturing, stock market, commodity markets, market funds, banking and other financial institutions, merger & acquisitions, human resources, trade unions, employee-employer relationship, technology & technological developments, consumers affairs and consumer protection, real estate business and corporate laws, international business etc, keeping in minds and the impact of all these on timeliness, prominence, novelty, conflict, proximity may be termed as Business Reporting.

In today’s competitive market a businessman does not deal in any particular product or market but it want to serve in multiple products / services and operates in different geographical areas. So it can cover wide area and face cut-thought competition when a business firm function in multiple products / service and in different market it need to properly anticipate and analyze risks and opportunities. All these information must be recorded in proper reports, which is known as segment reporting.

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