ACCT 102 – Managerial Accounting
Chapter 22– Decentralized Operations and Performance Evaluation – aka Responsibility Accounting
Chapter Notes - Johnson

Decentralization – literally means "not centralized". It means taking power away from the top and delegating it to lower level managers. A company is organized into divisions or subunits with a varying degree of responsibilities. This becomes necessary as a company becomes so large and complex that there is a need to break it town into separate divisions to increase efficiency and effectiveness.

Advantages and Disadvantages – See separate handout.

Departmental Accounting Systems - The accounting system needs to be designed to provide information based on the varying levels of activity. When accounts are maintained separately in the G/L the some type of departmental spreadsheet analysis should be done.

Department Expense Allocation – Decentralization creates some accounting challenges. A properly designed accounting system can help negate this. When that's not possible, more analysis may be needed to charge direct expenses properly and allocate indirect expenses in a reasonable manner.

Direct and Indirect Expenses – ***Direct expenses*** can be readily traced to a department and are for the sole benefit of that department. ***Indirect expenses*** usually have a joint benefit to many departments. Measuring the portion that each department gets charged can be a bit trickier. There is no standard rule. Similar to how overhead costs were allocated, you should try and look for a reasonable basis and go from there. For example, rental costs might be based on the square footage that each department uses. Payroll costs might be based on time cards where employees track what jobs they work on. Advertising might be based on a percentage of sales, and perhaps utilities are based on square footage . For service departments that benefit the company as a whole, you might allocate costs based on other factors. There is a list of these on the bottom of page 913.

A step down allocation of departmental charges must follow a systematic method. Supporting schedules are often done to calculate allocations based on a variety of different bases. There is an example of a master schedule on page 915 with supporting schedules on p. 916/917.

Common types of "Centers" or units:

- **Cost Centers** – Managers are only responsible for controlling the costs incurred. Reports will typically compare actual costs to budgeted costs. See page 923.

- **Profit Centers** – Manager has responsibility and authority to make decisions that affect both costs and revenues (or profits.) Reports will typically be a modified income statement that contains only the controllable costs. The report might look like this:

For a merchandiser	For **a non-merchandiser**:
Sales	Revenues
<u>Less COGS</u>	<u>Operating Expenses</u>
Gross Profit	Income before Indirect charges
<u>Less Direct operating expenses</u>	<u>Indirect service charges</u>
Income before Indirect charges	Controllable Operating Income
<u>Less Allocation of Indirect charges</u>	
Controllable Operating Income	

- **Investment Centers** – The Manager has the same responsibility as the profit center manager but with another added responsibility; the acquiring and utilization of assets. These investment centers are used in highly diversified companies. The financial reporting (often times) is treated as it's own entity. In addition to utilizing income statements to assess performance, other measures are added which assess how well the assets are being utilized. The return on investment calculations are commonly used to assess performance.

(Covered in Decision Analysis Section of text)

Basic ROI

$$= \frac{\text{Net Income}}{\text{Invested Assets}}$$

Expanded ROI

(also known as DuPont Formula)

$$= \text{Profit Margin} \times \text{Investment Turnover}$$

$$\frac{\text{Net Income}}{\text{Sales}} \times \frac{\text{Sales}}{\text{Invested Assets}}$$

Profit margin–shows profitability and how much profit is earned on every dollar

Investment Turnover–
focuses on
efficiency and how well assets are utilized. This measures how many sales were generated for each dollar invested.

Other measures:

Residual Income – or “left over” income measures how much above the desired minimum the company earned. It is usually used in conjunction with ROI (not in place of) to help assess performance.

Residual Income =   Investment Center Net Income – Targeted Net Income
(Very similar to the margin of safety concept discussed in the break-even chapter.)

Non-Financial Performance Measures –

Examples are abundant. Fed ex tracks on-time deliveries, airlines track on time flights, Walmarts ask customers on credit card transaction screens whether they had a pleasant experience, hotels send customers incentives to rank portions of their stay, etc. Some companies use a “balanced scorecard” to measure things.

Responsibility Accounting – insures there are useful and meaningful reports that show whether the manager was able to manage and control the areas under their purview of responsibility. It breaks costs down according to the level of control that a manager has over the costs.   A company is usually divided into subunits and the information provided for a specific level is directly related to the level the responsibility he/she has. The information must be provided in a timely manner so that any measures can be taken before costs spiral out of control.

(We will not cover the Appendix information related to transfer pricing and joint costs.)