ACCT 102 – Fundamentals of Accounting II
Ch 22 – Decentralization and Performance Evaluation

Departmental Accounting – separating a business into divisions, or operating units, and delegating responsibility to unit managers to provide information for managers to evaluate the profitability or cost effectiveness of each department's activities.

Advantages:

1. Lower-level managers can react more quickly to problems or changes in operations.
2. Lower-level managers are closer to the customer and more responsive to the customer's needs.
3. The operation provides a better training ground for managers.
4. Delegation improves employee morale.
5. Top management is free to devote time to strategic planning.

Disadvantages:

1. Assets and operating costs are duplicated (e.g., each division has its own administrative staff).
2. Managers may pursue their own goals and interests

Responsibility Centers – Controls costs and expenses and evaluate managers' performances by assigning costs and expenses to the managers responsible for controlling them; used to assist unit managers in evaluating and controlling their areas of responsibility.

Responsibility Accounting – the process of measuring and reporting operating data by responsibility center.

Cost Centers – Incurs costs without directly generating revenue. Managers are held accountable for controlling costs for their cost center. Manufacturing departments are usually cost centers.

Profit Centers – Incurs costs and generates revenues. Managers are held accountable for controlling costs and making decisions that impact revenues (and thus profits). Selling departments are usually evaluated as profit centers.

Controllable Revenues – revenues earned by the profit center

Controllable Expenses – costs that can be controlled by the decisions of the profit center manager (Direct Expenses)

Service Department Charges – expenses for services provided by internal centralized service departments.

Departmental Income Statements – Income Statements are prepared for each department as well as for the company as a whole.

Step 1: Accumulate direct expenses by department

Step 2: Allocate indirect expenses by department

Step 3: Allocate service department expenses to operating departments

Step 4: Prepare Departmental Income Statements

Example – Annette Chorde was so successful with her tennis court nets that she expanded her business to include pickle ball court nets. The two divisions operate as separate responsibility centers.

The results of operations for the two divisions are as follows:

	Pickle Ball Nets	Tennis Nets
Revenues	$56,000	$96,000
Cost of Goods Sold	30,000	49,000
Gross Profit	26,000	47,000
Operating Expenses	10,000	15,000
Income from Operations before Service department charges	16,000	32,000
Service department charges:		
Payroll		
Rent		
Total Service Dept. Charges		
Income from Operations		

Service Department Charges:

	Expenses	Activity Base
Payroll	$12,000	Number of Payroll Checks
Rent	25,000	Square footage occupied
	37,000	

Service Usage:

	Payroll	Rent
Pickle Ball	500 paychecks	1200 sq. feet
Tennis	1500 paychecks	1925 sq. feet
	2000	3125

Service Department charge rates:

Investment Centers

Financial Performance Evaluation Measures

Investment Centers – unit managers have the responsibility and authority to make decisions that effect not only costs and revenues but also the assets invested in the profit center.

Managers are also accountable for the efficient use of assets by measuring the profit generated by assets used in their divisions.

Return on Investment (Return on Total Assets) – measures profitability relative to the amount of assets invested in each division. The higher the ROI, the better the division utilizes its assets to generate income.

$$\text{ROI} = \frac{\text{Investment Center Net Income}}{\text{Investment Center Average Invested Assets}}$$

$$\text{ROI} = \frac{\text{Investment Center Net Income}}{\text{Investment Center Sales}} \times \frac{\text{Investment Center Sales}}{\text{Investment Center Avg Assets}}$$

Residual Income = Investment Center Net Income – Target Inv Center Net Income

ROI

	Pickle Ball Nets	Tennis Nets
Invested Assets	15,000	60,000
Target Net Income	2,000	10,000