THIRUTHANGAL NADAR COLLEGE

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A Self-Financing Co-educational College of Arts & Science

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NAME OF THE DEPARMENT: Dept. of Commerce (AF & BM)

SUBJECT :Financial planning & Performance

TOPIC : Responsibility Centres

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RESPONSIBILITY CENTRES

A **responsibility center** is an organizational unit headed by a manager, who is responsible for its activities and results.

In **responsibility** accounting, revenues and cost information are collected and reported on by **responsibility centers**.

TYPES OF RESPONSIBILITY CENTRES

1. Cost Centre:

A cost or expense centre is a segment of an organisation in which the managers are held responsible for the cost incurred in that segment but not for revenues. Responsibility in a cost centre is restricted to cost. For planning purposes, the budget estimates are cost estimates; for control purposes, performance evaluation is guided by a cost variance equal to the difference between the actual and budgeted costs for a given period. Cost centre managers have control over some or all of the costs in their segment of business, but not over revenues. Cost centres are widely used forms of responsibility centres.

a) Production Cost Centre:

It is a cost centre where production of goods is done such as in steel rolling mill hot mill, cold mill, hardening, polishing and grinding departments can be cost centres. The number of production cost centres in a factory depends upon the nature of industry, type of work performed and the size of the factory.

(b) Service Cost Centre:

It is a cost centre which renders services to production cost centres. It is not directly engaged in production though its existence is very essential for smooth and efficient running of production departments.

(c) Ancillary Manufacturing or Partly Producing Cost Centre:

Such type of cost centre may normally be a service department but sometimes does some productive work.

2. Revenue Centre:

A revenue centre is a segment of the organisation 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 expense of the marketing department. The performance of a revenue centre is evaluated by comparing the actual revenue with budgeted revenue, and actual marketing expenses with budgeted marketing expenses. The Marketing Manager of a product line, or an individual sales representative are examples of revenue centres.

3. Profit Centre:

A profit centre is a segment of an organisation whose manager is responsible for both revenues and costs. In a profit centre, the manager has the responsibility and the authority to make decisions that affect both costs and revenues (and thus profits) for the department or division. The main purpose of a profit centre is to earn profit. Profit centre managers aim at both the production and marketing of a product.

Mostly profit centres are created in an organisation in which they (profit divisions) sell products or services outside the company. In some cases, profit centres may be selling products or services within the company. For example, repairs and maintenance department in a company can be treated as a profit centre if it is allowed to bill other production departments for the services provided to them.

Benefits of Creating Profit Centres:

i) Better planning and decision making—Profit centres managers are independent in managing the activities and are responsible for profit and success of their business units. This encourages them to make better planning, profitable decisions and exercise control.

ii) Participation in organizational plans and policies— Although profit centre managers are independent in the management of their business units, they function within the umbrella of overall organization.

iii) Beneficial competitive environment—All profit centres managers target success and profit by managing costs and aiming higher revenues. This creates a competitive environment among the managers managing their respective business units which is not only beneficial for them but also contributes in achieving the overall objectives of the firm and in maximizing the firm profit.

4. Contribution Centre:

It is centre whose performance is mainly measured by the contribution it earns. Contribution is the difference between sales and variable costs. It is a centre devoted to increasing contribution. The main responsibility of the manager of such a responsibility centre is to increase contribution. Higher the contribution better will be the performance of the manager of a contribution centre.

5. Investment Centre:

An investment centre is responsible for both profits and investments. The investment centre manager has control over revenues, expenses and the amounts invested in the centre's assets. He also formulates the credit policy which has a direct influence on debt collection, and the inventory policy which determines the investment in inventory.

The manager of an investment centre has more authority and responsibility than the manager of either a cost centre or a profit centre. Besides controlling costs and revenues, he has investment responsibility too. 'Investment on asset' responsibility means the authority to buy, sell and use divisional assets.

Transfer Pricing – Purpose & Methodologies

Transfer pricing can be defined as the value which is attached to the goods or services transferred between related parties. In other words, transfer pricing is the price which is paid for goods or services transferred from one unit of an organization to its other units situated in different countries (with exceptions).

Transactions subject to Transfer pricing

The following are some of the typical international transactions which are governed by the transfer pricing rules:

Sale of finished goods .,Purchase of raw material;

Purchase of fixed assets;Sale or purchase of machinery etc.

Sale or purchase of Intangibles.Reimbursement of expenses paid/received;IT Enabled services;Support services;

Software Development services;Technical Service fees;

Management fees;Royalty fee;Corporate Guarantee fees;

Loan received or paid.

Purposes of Transfer Pricing

The key objectives behind having transfer pricing are:

Generating separate profit for each of the divisions and enabling performance evaluation of each division separately.

Transfer prices would affect not just the reported profits of every center, but would also affect the allocation of a company's resources (Cost incurred by one centre will be considered as the resources utilized by them).

Why Organizations need to understand Transfer Pricing

For the purpose of management accounting and reporting, multinational companies (MNCs) have some amount of discretion while defining how to distribute the profits and expenses to the subsidiaries located in various countries. Sometimes a subsidiary of a company might be divided into segments or might be accounted for as a standalone business. In these cases, transfer pricing helps in allocating revenue and expenses to such subsidiaries in the right manner.

It is important that a business having cross-border intercompany transactions should understand transfer pricing concept, particularly for the compliance requirements as per law and to eliminate the risks of non-compliance.

Transfer Pricing Methodologies

The following are three of the most commonly used transfer pricing methodologies:
For the purpose of understanding, associated enterprises refer to an enterprise which directly or indirectly participates in the management or capital or control of another enterprise.

1.Comparable Uncontrolled Price (CUP) Method

Under CUP method, a price which is charged in an uncontrolled transaction between the comparable firms is recognized and evaluated with a verified entity price for determining the Arm's Length Price.

2.Resale Price Method or Resale Minus Method

In this method, it takes the prices at which the associated enterprise sells its product to the third party. This price is referred to as the resale price. The gross margin which is determined by comparing the gross margins in a comparable uncontrolled transaction is then reduced from this resale price. After this, costs which are associated with the purchase of such product such as the customs duty are deducted. What remains is considered as arm's length price for a controlled transaction between the associated enterprises.

3.Cost Plus Method

With Cost Plus Method, you emphasize on costs of the supplier of goods or services in the controlled transaction. Once you're aware of the costs, you need to add a markup. This markup must reflect the profit for the associated enterprise on basis of risks and functions performed. The result is the arm's' length price. Generally, the markup in the cost plus method would be calculated after the direct and indirect cost related to production or supply is considered. But, operating expenses of an enterprise (like overhead expenses) aren't part of this markup.

Problems associated with Transfer Pricing

There are quite a few problems associated with the transfer prices. Some of these issues include:

There could be differences in opinions among organizational divisional managers with respect to how transfer price needs to be set.

Additional time, costs and manpower would be required for executing the transfer prices and designing the accounting system to match the requirements of transfer pricing rules.

Arm’s length prices might cause functional behavior among the managers of organizational units.

For some of the divisions or departments, for instance, a service department, arm’s length prices don’t work equally as well as such departments don’t offer measurable benefits.

The transfer pricing issue in a multinational setup is very complicated.

Domestic transfer pricing

Till March 2013, the transfer pricing provisions were limited to international transactions alone.

From April 2013 Transfer Pricing provisions have been extended to SDTs (Specified Domestic Transactions) and applicable from the assessment year 2013-14.

•Transactions which are covered under the Specified Domestic Transactions include:Expenditures in which payment has been made or would be made to:**a.** A director**b.** A relative of the director**c.** An entity where a director or the company has the voting interest exceeding 20%

•Transactions which relates to transfer of goods or services provided in Section 80-IA (8) & (10

•For undertakings which are established in SEZs (special economic zones), free trade zone or EOUs (export-oriented units) involving transfer of goods and services to another unit .