RESPONSIBILITY CENTERS AND ENTITY BUDGETS

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Abstract

The investigation on relationships between responsibility centers and budgets supposes examining the influence of management control over the entity management structures. Thus, responsibility centers help to streamline the management structure and ensure the implementation of the budget system into practice. Budgeting refers to the transformation of financial plans into monetary units. The pragmatic approach of the relationship between responsibility centers and budgets is analyzed on the basis of Romanian entities in the regulated market of the Bucharest Stock Exchange. The fact that entities which show the management structure and at the same time show the income and expense budget makes us claim that both have an important role to play in implementing the entity strategies.

Keywords: Responsibility centers, decentralized system, income and expense budget.


Introduction

Responsibility centers are the right tool for transposing the top management objectives in the general budget figures, and, in order to guarantee their realization, the efforts of all employees at all levels are supervised. Financial structures within the responsibility centers are designed to ensure the implementation of the budget system. Assigning responsibility for their actions managers present one of the measures for coordinating the company’s efforts.

Responsibility centers are considered a subset of the organization, which has its own leadership role to authorize the use of resources (human, material and financial) envisaged in a budget, and performance is measured against a set of accounting criteria, confirmed positively or negatively through promotion bonuses [4]. The typology of responsibility centers is resumed to one of the following activities: conditional outputs (production of goods and services) participating in the increase of turnover, benefit from inputs (goods or services purchased), contributing to increased costs (expenses), or creates conditions for the activities of departments, generating resource inputs or outputs [11]. A responsibility center is part of the entity to which a manager has the authority to make decisions and bear responsibility for their decisions.

Decentralized decision-making system

Entities with a complex and diversified activity usually can choose one of two approaches: the decision making centralized or decentralized mechanisms. The centralized system provides that decisions are taken at top management level and mid-level managers and operational management ensures the implementation of decisions. The decentralized system enables middle and operational management to implement key decisions of top management and making decisions related to their areas of responsibility. Decentralization process marks the practice of delegating decision-making to lower levels [7].

In larger entities, duties and responsibilities are divided and contribute, ultimately, to the creation of responsibility centers. Responsibility is closely related to decision-making authority. Most companies tend to be decentralized in decision-making authority. In general, the activities of an entity are organized along the lines of responsibility. The traditional organizational chart, in pyramidal shape, illustrates these lines: Executive Director (CEO), middle managers and operational managers. As entities grow in size, the lines of responsibility are becoming longer and more numerous. A strong link exists between organizational structure, responsibilities and accounting system in order to support the structure of an entity.
Responsibility centers

As business expands, the top management shapes also the area of responsibilities naming them responsibility centers, assigning them subordinate managers. Such a center is a business segment assigned to a manager responsible for the series of relevant activities. Responsibility is a system that measures the performance of each responsibility center and compares them with the expected outcome in the budget. The five categories of responsibility centers are as follows:

1. Cost centers: the manager is responsible for costs;
2. Revenue centers: the manager is responsible for both revenue and costs;
3. Profit centers: the manager is responsible for profit center revenues. Revenues and operating expenses are divided according to types of products, customer groups or geographical areas [10]. The appropriate use resources and respecting the limits of revenue by maximizing the value represent the extremities in performance measurement.
4. Investment centers: the manager is responsible for investments to increase future benefits. Such responsibility center should ensure the minimum cost, highest quality and the shortest production time. But the head of the production department does not set the price and does not take decisions on the launch of the products.
5. Discretionary spending centers: similar to costs center

Cost, revenue and profit centers consider short periods up to one year, while investment and discretionary spending centers refer to periods greater than one year. For example, the production department within a manufacturing entity marks a cost center and its supervisor is assessed in terms of the quality of supervision costs and the gap between projected and actual data on the cost of products manufactured or services rendered. Such responsibility center should ensure the minimum cost, highest quality and the shortest production time. But the head of the production department does not set the price and does not take decisions on the launch of the products.

In this view, the sales department (marketing) can be seen as a revenue center and its manager bears responsibility for pricing and sales forecasting. Performance evaluation is focused on turnover. This indicator can be divided according to types of products, customer groups or geographical areas [10]. The appropriate use resources and respecting the limits of revenue by maximizing the value represent the extremities in performance measurement.

In some companies, operational managers (plant managers) bear responsibility for pricing and selling the goods they produce. The profit center is the department that has the responsibility revenues. Revenues and operating expenses provide the basis for evaluating performance for profit center managers, they provide the opportunity and have the power to control at the same time, price and volume of sales, distribution costs, cost of sales, administrative expenses, expenses for research and development etc.

Finally, the aforementioned divisions often are contacted by the management of investment center, which bears responsibility for the use of assets. Usually, the head of the investment center is rarely subject to an integral control of all assets. Inventory, customer receivables and current assets is cash are under the management of investment center, while the fixed assets are in part management, based on the decision of top management. Investment centers are evaluated based on return on invested capital: the best combination of immediate profit and investments to increase future benefits [10]. Invested capital should not be confused with the very capital, but it represents the total investment funds (fixed assets, inventory, customer receivables) except for cash.

Discretionary expenditures cover some services designed to help operational activity [3], and their size depends on the “discretion” of the manager. Such centers should have its own budget, discussed in advance with top management and covering a period longer than one year, although in the literature the are treated, most often, within the cost center. Performance evaluation is very complicated because it has to be associated with research and development center (number of new products developed, the results of ongoing projects, respect of budgetary limits, the ratio between the amounts invested and the income earned).

Budget planner

The budget refers to the government, simulation, motivation and conflict prevention tools. This also refers to the last stage of planning, which facilitates the transition from the long term to the short term going through the following steps:

- plans regroup the strategic guidelines of the entity on medium and long term, presenting the measures to be implemented by the responsibility centers;
- programs refers to short-term action plans, which determine the objectives and means. Forecasts are made in physical units;
- budgets are related to the implementation stage of programs, turning them into currency units.

The task of making the budgets of an entity should not be the sole responsibility of one department. At the same time, the budget should not be considered as the last word from the top management. The algorithm of budgeting becomes more useful if the figures and the estimates it includes are the result of a bottom-up process. For example, the sales department estimates the sales and the production department is responsible for budgeting its own spending. The budget system requires central guidance in order to avoid the risk when the employees, who are actively involved in preparing the budget, provide a Supervisory committee to the budgeting process has to check whether the figures shown in the budget are real. If a department keeps to the originally budgeted figures which do not reflect the performance, the Budget Committee should come up with comments on how to make improvements. The department of origin must
justify its proposals or explain why they are acceptable. Communication between the department of origin and the Budget Committee is to ensure that both sides accept the budget as being reasonable, achievable and desirable.

The budget can be developed downwards or upwards. In the latter case [1], budgets are imposed on employees by their managers, while the former favors the employee’s involvement in the first step of creating budgets. Regardless of the initial approach, the final budget must be the result of negotiations between top management, middle and operational management. Advantages of downward budgeting suppose a shorter period of preparation, avoids prejudices, raises the top management awareness regarding the availability of resources. The bottom-up/downward budgeting favors the inclusion of detailed information on forecasted processes, the improvement of ethics and employees’ motivation, high possibility of meeting budgets.

The best performance is usually achieved when a budget is perceived as an achievable challenge. Goals should be set at a level of “about to be achieved” in order to get maximum motivation and performance. The relationship between goals is a vital factor, which implies the compliance of management objectives with the entity's objectives overall. In budgeting, accountants must ensure that compliance and employees have a positive attitude towards the development and implementation of budgets along with the feedback results.

As a result of the complex structure, budgets must interact between departments in a mutually agreed way. A budget developed by one department is often an essential element in the budget development of another department. Each department develops its own budget or provides information to be classified. The budget is developed, typically for a year and then divided by months (quarters) [7]. Most entities develop the budget for next year during the last four or five months of the current year.

The budgeting process begins with the sales department by estimating the types, quantities and sales timing for the company products. A production manager combines the sales estimates with the information on the products sold in the earlier periods, to specify the types, quantities and the lead time products are to be manufactured. Sales estimation patterns, coordinated with the estimated cash receipts are used to determine the amount and timing of cash receipts. The budget which refers to the use of various resources, coordinated with other budgets, integrates in the budget of financial statements [12].

A general (master) well-prepared budget can act as:

- a guide for managers in matching activities and resources with the objectives of the entity;
- a means of promoting cooperation, department coordination and employees participation;
- a tool to improve managerial behavior in completing the planning, control, conflict resolution and performance assessment functions;
- a tool for emphasizing the management capacity to respond to changes in the internal and external environments;
- a model that exhibits a rough view on the future performance of the company and the consideration of alternative measures [12].

The criticisms brought to the general budget [7] refer to the following: the department unit avoids the recognition of interdepartmental actions, has a static nature and is focused on results, but not on processes. In traditional budgeting, each department develops its own budget. These budgets are then aggregated to form the overall budget of the company. Each department starts by determining the resources it currently holds in order to adjust the budget to the potential level of output (production). As a result, the traditional budgeting creates the feeling that "each department works for itself." Managers are encouraged to use every dollar from the budgeted resources, no matter these resources are needed or not. Indeed, if the department has not fully utilized the budgeted resources it might have time to react in order to increase or store the same amount of resources next year.

The real situation of the techniques and tools used by responsibility centers in the Romanian entities has been examined based on the management annual reports for 2015, listed on the website of the Bucharest Stock Exchange.
In November 2016 they selected 50 entity reports from the regulated market. Based on content analysis they selected the main characteristics of the decision-delegation process within the entity. Out of the selected reports, they withdrew the information on corporate governance and the algorithm for delegating decisions and taking responsibilities. Out of 50 entities, only Romcarbon S.A. has presented information on profit centers in its report. For the rest, they examined the sections on governance or with reference to the management structure, as only 10% of reports contain the organizational structure. After examining the categories from Figure 1, we can claim that the largest share is held by the entities which have included both the entity management structure and the income and expenses budget in their annual management reports.

After examining the information presented on the Bucharest Stock Exchange website, we can state that 35 out of 51 entities listed on the regulated market have placed the revenue and expenditure budget along with the management annual reports and financial statements. The categories from Figure 2 show that budgets are not a strictly regulated structure. The largest share (47%) is held by budgets that have included only the income and expenses for the year of 2016. Some of these entities have submitted the income and expenses by quarters, e.g. Bermas SA, Prefab SA, Romcarbon SA, SIF Transilvania SA, Socep SA, Rompetrol Well Services SA.
Conclusion

In conclusion we wish to affirm that entities prefer decentralized management, an approach aimed at:
- Opportunity of delegating the decision-making to lower levels is that issues are discussed in detail for each section which has better local information (e.g. local power and nature of competition, the nature of the local labour force). As a result, local managers are often in a position to make better decisions;
- The information within a centralized system spreads harder; requiring local time for submission of information to headquarters and vice versa. Local managers act quickly to customer requests, local government etc. As a result, they are able to more timely responses in making decisions.

The income and expenses budget constitute the final stage of planning and the first stage of control. A budget matching the real situation can represent a guide for managers in matching activities and resources with the entity objectives, a means of promoting cooperation, departmental coordination and employee participation, a tool to improve the managerial behavior in carrying out the functions of planning, controlling, problem solving and performance appraisal.

Therefore, the degree of achieving objectives depends on the management structure within the entity and the operational activity initiated by the income and expenses budget. The management control issues refer to the extent objectives are achieved and whether the allocated resources match the forecasts.

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