

STRATEGIC BUSINESS ANALYSIS

RESPONSIBILITY REPORTING & CONTROL AND EVALUATION OF COST CENTERS

(TOPIC 15)

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GOAL CONGRUENCE & MOTIVATION

Goal congruence is a situation in which people in multiple levels of an organization share the same goal. The system can achieve its goal more effectively and perform better when organizational goals can be aligned with the personal and group goals of subordinates and superiors.

Benefits:

1. Cooperation and collaboration
2. Effective decision making
3. Effective performance management
4. Staff engagement and motivation

8 WAYS TO ACHIEVE GOAL CONGRUENCE

1. Set clear organizational goals
2. Match individual goals to the organizational goals
3. Involve employees
4. Create goal-aligned metrics
5. Establish goal-aligned incentives
6. Develop a supportive culture
7. Provide sufficient resources
8. Adjust goals as needed

RESPONSIBILITY CENTERS

It is a part, segment, unit or function of an organization, headed by a manager, who is accountable for a specified set of activities.

1. Investment Center
2. Profitability center
3. Revenue center
4. Cost center

RESPONSIBILITY REPORTING

Also known as responsibility accounting. It is a system of responsibility reporting and control. The focus is on specific unit within the organization that are responsible for the accomplishment of specific activities.

Responsibility accounting aims to:

- Ensure that all costs and revenues are properly credited to the correct responsibility center
- Provide a basis for making decisions for future operations
- Monitor the performance of each responsibility center and evaluation of the effectiveness of agency's operations.

PERFORMANCE EVALUATION CRITERIA FOR COST CENTERS

- **Budget Variance (Actual Vs Budgeted Costs)** - This measures the difference between the actual costs incurred by the cost center and the budgeted or planned costs.
- **Service Quality/Quantity** - Assesses the volume and quality of services or outputs the cost center delivers.
- **Controllability of Costs** - Evaluates performance based on costs that the manager has direct influence over, separating controllable from non-controllable costs for fair assessment
- **Cost Allocation** - It distributes indirect or shared costs from support departments to producing or profit centers based on usage or benefit, ensuring accurate performance measurement in decentralized organizations.

COST ALLOCATION METHODS

1. Direct Method

Allocates support department costs directly to producing departments, ignoring inter-support interactions for simplicity.

2. Step Down Method

Allocates costs sequentially from one support department to others and producing departments, recognizing some mutual services.

3. Reciprocal Method

Fully accounts for mutual services between support departments using simultaneous equations or iterative calculations for precision.

4. Activity Based Costing (ABC Method)

Assigns costs via cost drivers like machine hours or transactions, improving accuracy for complex operations.

EFFECT OF COST ALLOCATION INCLUDING ETHICS

POSITIVE EFFECTIVE

- Enhances manager accountability and efficiency by linking costs to activities, motivating reductions like optimizing department space after utility allocations.
- Boosts decision-making and performance through accurate methods like ABC, enabling resource reallocation for higher margins.
- Improves true cost visibility for better budgeting, pricing, and profitability analysis, such as identifying unprofitable products for discontinuation.

NEGATIVE EFFECT

- Causes biases in sequential allocations based on order, ignoring reciprocal services and unfairly charging departments.
- Sparks internal conflicts as units resist charges to protect profits, reducing collaboration.
- Distorts metrics with inaccurate methods, leading to poor decisions like overpricing or retaining loss-making lines

ETHICAL CONSIDERATIONS

- Mitigated by transparency, audits, and consistent policies for integrity.
- Demands cause-and-effect fairness to prevent manipulations like cost-shifting for bonuses, ensuring equitable evaluations.

STANDARD COSTS

- Predetermined costs for materials, labor, and overhead
- Serve as a guide for planning, budgeting, and control
- Help measure efficiency and identify areas for improvement

VARIANCES

- Difference between **actual costs** and **standard costs**
- Signal areas for investigation and improvements

Types of variances:

- **Material** - price & quantity
- **Labor** - rate & efficiency
- **Overhead** - spending, efficiency, volume

CONTINUOUS IMPROVEMENT

- Variances highlight inefficiencies and corrective actions
- Supports better decision-making, productivity, and quality
- Encourages ongoing evaluation of operations

STANDARD COSTS FOR NONMANUFACTURING ACTIVITIES

- Applied to selling, administrative, and service departments
- *Examples:* customer orders, sales visits, document processing
- Benefits:
 1. Control Expenses
 2. Improve Efficiency
 3. Promote Accountability