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CH: BUDEGET AND BUDEGETARY CONTROL
THEORY

CH: Budget and Budgetary Control

Meaning and Definition of Budget, Budgeting and Budgetary Control:

Budget: A budget is the monetary and / or quantitative expression of business plans and policies to be pursued in the future period of time. Budgeting is preparing budgets and other procedures for planning, coordination and control of business enterprises.

I.C.M.A. defines a budget as “A financial and / or quantitative statement, prepared prior to a defined period of time, of the policy to be pursued during that period for the purpose of attaining a given objective”.

Budgeting refers to the process of preparing the budgets. It involves a detailed study of business environment clearly grasping the management objectives, the available resources of the enterprise and capacity of the enterprise.

Budgeting is defined by J.Batty as under: “The entire process of preparing the budgets is known as budgeting”.

Thus budgeting is a process of making the budget plans. Preparation of budgets or budgeting is a planning function and their implementation is a control function. ‘Budgetary control’ starts with budgeting and ends with control.

Budgetary control is the process of preparation of budgets for various activities and comparing the budgeted figures for arriving at deviations if any, which are to be eliminated in future. Thus budget is a means and budgetary control is the end result. Budgetary control is a continuous process which helps in planning and coordination. It also provides a method of control.

According to Brown and Howard “Budgetary control is a system of coordinating costs which includes the preparation of budgets, coordinating the work of departments and establishing

responsibilities, comparing the actual performance with the budgeted and acting upon results to achieve maximum profitability”.

Wheldon characterizes budgetary control as planning in advance of the various functions of a business so that the business as a whole is controlled.

I.C.M.A. define budgetary control as “the establishment of budgets, relating the responsibilities of executives to the requirements of a policy, and the continuous comparison of actual with budgeted results either to secure by individual actions the objectives of that policy or to provide a basis for its revision”.

Features of Budgetary Control:

A budgetary control system can be defined as the establishment of budgets relating to the responsibilities of executives to the requirements of a policy, and the continuous comparison of actual with budgeted results either to secure by individual action the objective of that policy or to provide a base for its revision.

The salient features of such a system are the following:

- (a) **Objectives:** Determining the objectives to be achieved, over the budget period, and the policy or policies that might be adopted for the achievement of these ends.
- (b) **Activities:** Determining the variety of activities that should be undertaken for the achievement of the objectives.
- (c) **Plans:** Drawing up a plan or a scheme of operation in respect of each class of activity in physical as well as monetary terms for the full budget period and its part.
- (d) **Performance evaluation:** Laying out a system of comparison of actual performance by each person, section or department with the relevant budget and determination of causes for the discrepancies, if any.
- (e) **Control Action:** Ensuring that corrective action will be taken where the plan is not being achieved and, if that is not possible, for the revision of the plan.

Objectives of Budgetary Control:

The following are the objectives of a budgetary control system:

- a) Planning:** A budget provides a detailed plan of action for a business over definite period of time. Detailed plans relating to production, sales, raw material requirements, labour needs, advertising and sales promotion performance, research and development activities, capital additions etc., are drawn up. By planning many problems are anticipated long before they arise and solutions can be sought through careful study. Thus most business emergencies can be avoided by planning. In brief, budgeting forces the management to think ahead, to anticipate and prepare for the anticipated conditions.
- b) Co-ordination:** Budgeting aids managers in co-coordinating their efforts so that objectives of the organisation as a whole harmonise with the objectives of its divisions. Effective planning and organisation contributes a lot in achieving coordination. There should be coordination in the budgets of various departments. For example, the budget of sales should be in coordination with the budget of production. Similarly, production budget should be prepared in co-ordination with the purchase budget, and so on.
- c) Communication:** A budget is a communication device. The approved budget copies are distributed to all management personnel who provide not only adequate understanding and knowledge of the programmes and policies to be followed but also gives knowledge about the restrictions to be adhered to. It is not the budget itself that facilitates communication, but the vital information is communicated in the act of preparing budgets and participation of all responsible individuals in this act.
- d) Motivation:** A budget is a useful device for motivating managers to perform in line with the company objectives. If individuals have actively participated in the preparation of budgets, it act as a strong motivating force to achieve the targets.
- e) Control:** Control is necessary to ensure that plans and objectives as laid down in the budgets are being achieved. Control, as applied to budgeting, is a systematized effort to keep the management informed of whether planned performance is being achieved or not. For this purpose, a comparison is made between plans and actual performance. The difference between the two is reported to the management for taking corrective action.

f) Performance Evaluation: A budget provides a useful means of informing managers how well they are performing in meeting targets they have previously helped to set. In many companies, there is a practice of rewarding employees on the basis of their achieving the budget targets or promotion of a manager may be linked to his budget achievement record.

Advantages of Budgetary Control:

A budget is a blue print of a plan expressed in quantitative terms. Budgeting is technique for formulating budgets. Budgetary Control, on the other hand, refers to the principles, procedures and practices of achieving given objectives through budgets.

Here are the some Advantages of Budgetary Control:

- a) Maximization of Profit:** The budgetary control aims at the maximization of profits of the enterprise. To achieve this aim, a proper planning and coordination of different functions is undertaken. There is proper control over various capital and revenue expenditures. The resources are put to the best possible use.
- b) Efficiency:** It enables the management to conduct its business activities in an efficient manner. Effective utilization of scarce resources, i.e. men, material, machinery, methods and money - is made possible.
- c) Specific Aims:** The plans, policies and goals are decided by the top management. All efforts are put together to reach the common goal of the organization. Every department is given a target to be achieved. The efforts are directed towards achieving some specific aims. If there is no definite aim then the efforts will be wasted in pursuing different aims.
- d) Performance evaluation:** It provides a yardstick for measuring and evaluating the performance of individuals and their departments.
- e) Economy:** The planning of expenditure will be systematic and there will be economy in spending. The finances will be put to optimum use. The benefits derived for the concern will ultimately extend to industry and then to national economy. The national resources will be used economically and wastage will be eliminated.

- f) Standard Costing and Variance analysis:** It creates suitable conditions for the implementation of standard costing system in a business organization. It reveals the deviations to management from the budgeted figures after making a comparison with actual figures.
- g) Corrective Action:** The management will be able to take corrective measures whenever there is a discrepancy in performance. The deviations will be regularly reported so that necessary action is taken at the earliest. In the absence of a budgetary control system the deviation can be determined only at the end of the financial period.
- h) Consciousness:** It creates budget consciousness among the employees. By fixing targets for the employees, they are made conscious of their responsibility. Everybody knows what he is expected to do and he continues with his work uninterrupted.
- i) Reduces Costs:** In the present day competitive world budgetary control has a significant role to play. Every businessman tries to reduce the cost of production for increasing sales. He tries to have those combinations of products where profitability is more.
- j) Policy formulation:** It helps in the review of current trends and framing of future policies.

Limitations of Budgetary Control System:

The list of advantages given above is impressive, but a budget is not a cure all for organisational ills. Budgetary control system suffers from certain limitations and those using the system should be fully aware of them.

- a) The budget plan is based on estimates:** Budgets are based on forecasting cannot be an exact science. Absolute accuracy, therefore, is not possible in forecasting and budgeting. The strength or weakness of the budgetary control system depends to a large extent, on the accuracy with which estimates are made. Thus, while using the system, the fact that budget is based on estimates must be kept in view.
- b) Danger of rigidity:** Budgets are considered as rigid document. Too much emphasis on budgets may affect day-to-day operations and ignores the dynamic state of organization functioning.

- c) **Budgeting is only a tool of management:** Budgeting cannot take the place of management but is only a tool of management. ‘The budget should be regarded not as a master, but as a servant.’ Sometimes it is believed that introduction of a budget programme alone is sufficient to ensure its success. Execution of a budget will not occur automatically. It is necessary that the entire organisation must participate enthusiastically in the programme for the realisation of the budgetary goals.
- d) **False Sense of Security:** Mere budgeting cannot lead to profitability. Budgets cannot be executed automatically. It may create a false sense of security that everything has been taken care of in the budgets.
- e) **Lack of coordination:** Staff co-operation is usually not available during budgetary control exercise.
- f) **Expensive Technique:** The installation and operation of a budgetary control system is a costly affair as it requires the employment of specialized staff and involves other expenditure which small concerns may find difficult to incur. However, it is essential that the cost of introducing and operating a budgetary control system should not exceed the benefits derived there from.

ZERO BASED BUDGETING

ZBB is defined as ‘a method of budgeting which requires each cost element to be specifically justified, as though the activities to which the budget relates were being undertaken for the first time. Without approval, the budget allowance is zero’.

Zero – base budgeting is so called because it requires each budget to be prepared and justified from zero, instead of simply using last year’s budget as a base. In Zero Based budgeting no reference is made to previous level expenditure. Zero based budgeting is completely indifferent to whether total budget is increasing or decreasing.

‘Zero base budgeting’ was originally developed by Peter A. Pyher at Texas Instruments. Peter A. Pyher has defined ZBB as “an operating, planning and budgeting process which requires

each manager to justify his entire budget request in detail from scratch (hence zero base) and shifts the burden of proof to each manager to justify why we should spend any money at all". CIMA has defined it "as a method of budgeting whereby all activities are reevaluated each time a budget is set."

Benefits and Limitations of Zero Base Budgeting

The major benefits of the use of zero base budgeting can be the following:

- a) Zero base budgeting examines all existing and new programmes and activities. It also makes the managers analyse their functions, establish priorities and rank them. This exercise helps in identifying inefficient or obsolete functions within the area of responsibility. In this way resources are allocated from low priority programmes to high priority programmes.
- b) This system facilitates identification of duplication of efforts among organisational units. Such inefficient activities are eliminated and some other activities are merged.
- c) All expenditures, under this system are critically reviewed and justified and all operations activities are evaluated in greater detail in terms of their cost effectiveness and cost-benefits. This requires managers to find alternative ways of performing their activities which may result in more efficient procedures.
- d) ZBB promotes the tendency to initiate studies and improvements during the period of operation as the persons at the helm of affairs know that the process would be exercised next year and their knowledge and training would enhance efficiency and cost-effectiveness.
- e) ZBB provides for quick budget adjustments during the year. If revenue falls short in this process, it offers the capability to quickly and rationally modify goals and expectations to correspond to a realistic and affordable plan of operations.
- f) ZBB ensures greater participation of personnel in formulation and ranking processes. This helps in promoting level of job satisfaction and thus resulting in better control and operational efficiency in the organisation.
- g) Zero base budgeting is a flexible tool that can be applied on a selective basis. It does not have to be applied throughout the entire organisation or even in all the service departments. Keeping in view the limitations of time, money and persons available to install, operate and

monitor it the management thus can select priority areas to which zero base budgeting may be applied.

Limitations of ZBB can be summed up as:

- a) It challenges the past practices, performance, attitudes, of people.
- b) It requires more time and effort.
- c) Detailed costs and necessary information for decision packages often are not made available.
- d) It increases paper work to unmanageable proportions.
- e) Ranking a large number of decision packages becomes an unwieldy process.
- f) Identifying various levels of funding, particularly the minimum level is a difficult task.

Types of Budgets

As budgets serve different purposes, different types of budgets have been developed.

The following are the different classification of budgets developed

On the basis of time,

Functions, and

Flexibility or capacity.

(A) Classification on the basis of Time:

- 1. Long-term budgets
- 2. Short-term budgets
- 3. Current budgets

(B) Classification according to functions:

- 1. Functional or subsidiary budgets
- 2. Master budgets

(C) Classification on the basis of capacity:

- 1. Fixed budgets.
- 2. Flexible budgets

(A) Classification on the basis of time

- 1. **Long-term budgets:** Long-term budgets are prepared for a longer period varies between five to ten years. It is usually developed by the top level management. These budgets

summarise the general plan of operations and its expected consequences. Long-term budgets are prepared for important activities like composition of its capital expenditure, new product development and research, long-term finance etc.

2. Short-term budgets: These budgets are usually prepared for a period of one year. Sometimes they may be prepared for shorter period as for quarterly or half yearly. The scope of budgeting activity may vary considerably among different organization.

3. Current budgets: Current budgets are prepared for the current operations of the business. The planning period of a budget generally in months or weeks. As per ICMA London, “Current budget is a budget which is established for use over a short period of time and related to current conditions.”

(b) Classification on the basis of function

1. Functional budget: The functional budget is one which relates to any of the functions of an organization. The number of functional budgets depends upon the size and nature of business.

The following are the commonly used:

- (i) Sales budget
- (ii) Purchase budget
- (iii) Production budget
- (iv) Selling and distribution cost budget
- (v) Labour cost budget
- (vi) Cash budget
- (vii) Capital expenditure budget

2. Master budget: The master budget is a summary budget. This budget encompasses all the functional activities into one harmonious unit. The ICMA England defines a Master Budget as the summary budget incorporating its functional budgets, which is finally approved, adopted and employed.

(C) Classification on the basis of capacity

1. Fixed budget: A fixed budget, on the other hand is a budget which is designed to remain unchanged irrespective of the level of activity actually attained. In a fixed budgetary control,

budgets are prepared for one level of activity whereas in a flexibility budgetary control system, a series of budgets are prepared one for each level of alternative production levels or volumes. According to ICWA London ‘Fixed budget is a budget which is designed to remain unchanged irrespective of the level of activity actually attained.’ Fixed budget is usually prepared before the beginning of the financial year. This type of budget is not going to highlight the cost variance due to the difference in the levels of activity. Fixed budgets are suitable under static conditions.

2. Flexible budget: A flexible budget is defined as “a budget which, by recognizing the difference between fixed, semi-variable and variable cost is designed to change in relation to the level of activity attained”. Flexible budgets represent the amount of expense that is reasonably necessary to achieve each level of output specified. In other words, the allowances given under flexibility budgetary control system serve as standards of what costs should be at each level of output.

According to ICMA, England defined Flexible Budget is a budget which is designed to change in accordance with the level of activity actually attained.” According to the principles that guide the preparation of the flexible budget a series of fixed budgets are drawn for different levels of activity. A flexible budget often shows the budgeted expenses against each item of cost corresponding to the different levels of activity. This budget has come into use for solving the problems caused by the application of the fixed budget.

Advantages of flexible budget

1. In flexible budget, all possible volume of output or level of activity can be covered.
2. Overhead costs are analysed into fixed variable and semi-variable costs.
3. Expenditure can be forecasted at different levels of activity.
4. It facilitates at all times related factor can be compared, which essential for intelligent decision are making.
5. A flexible budget can be prepared with standard costing or without standard costing depending upon what the company opts for.

6. A flexible budget facilitates ascertainment of costs at different levels of activity, price fixation, placing tenders and quotations.
7. It helps in assessing the performance of all departmental heads as the same can be judged by terms of the level of activity attained by the business.

Method of preparing flexible budget

The following methods are used in preparing a flexible budget:

1. Multi-activity method
2. Ratio method
3. Charting method.

1. Multi-Activity method: This method involves preparing a budget in response to different level of activity. The different level of activity or capacity levels are shown in Horizontal columns, and the budgeted figures against such levels are placed in the Vertical Columns. The expenses involved in production as per budget are grouped as fixed, variable and semi variable.

2. Ratio method: According to this method, the budget is prepared first showing the expected normal level of activity and the estimated variable cost per unit at the side expected level of activity in addition to the fixed cost as estimated. Therefore, the expenses as per budget, allowed for a particular level of activity attained, will be calculated on the basis of the following formula: Budgeted fixed cost + (Variable cost per unit of activity × Actual unit of activity).

3. Charting method: Under this method total expenses required for any level of activity, are estimated having classified into three categories, viz., variable, semi variable and fixed. These figures are plotted on a graph. The expenses are plotted on the Y-axis and the level of activity is plotted on X-axis. The graphs will thus, help in ascertaining the quantum of budgeted expenses corresponding to the level of activity attained with the help of this chart.

Sales Budget

Sales budget is one of the important functional budgets. Sales estimate is the commencement of budgeting may be both made in quantitative or in value terms. Sales budget is primarily concerned with forecasting of what products will be sold in what quantities and at what prices during the budget period. Sales budget is prepared by the sales executives taking into account

number of relevant and influencing factors such as: Analysis of past sales, key factors, market conditions, production capacity, government restrictions, competitor's strength and weakness, advertisement, publicity and sales promotion, pricing policy, consumer behaviour, nature of business, types of product, company objectives, salesmen's report, marketing research's reports, and product life cycle.

Production Budget

Production budget is usually prepared on the basis of sales budget. But it also takes into account the stock levels desired to be maintained. The estimated output of business firm during a budget period will be forecast in production budget. The production budget determines the level of activity of the produce business and facilities planning of production so as to maximum efficiency. The production budget is prepared by the chief executives of the production department. While preparing the production budget, the factors like estimated sales, availability of raw materials, plant capacity, availability of labour, budgeted stock requirements etc. are carefully considered.

Difference between Sales Budget and Production Budget

- a) A sales Budget is a schedule, which shows expected sales in both units and sales rupees for the coming period. Whereas a production budget determines only the quantity to be produced in coming period.
- b) A sales Budget is not prepared on the basis of production budget. But a production budget is prepared on the basis of sales budget.
- c) Stock levels are not shown in sales budget. But, a production budget takes into account the stock levels desired to be maintained.
- d) Sales budget is prepared by the sales executives. Whereas, production budget is prepared by the chief executives of the production department.
- e) Estimated selling price is shown in sales budget. Whereas, production budget helps in calculating production cost for estimated level of production.

Cost of production Budget

After preparation of production budget, this budget is prepared. Production cost budgets show the cost of the production determined in the production budget. Cost of production budget is grouped in to material cost budget, labour cost budget and overhead cost budget. Because it break up the cost of each product into three main elements material, labour and overheads. Overheads may be further subdivided in to fixed, variable and semi-fixed overheads. Therefore separate budgets required for each item.

Master Budget

When the functional budgets have been completed, the budget committee will prepare a master budget for the target of the concern. Accordingly a budget which is prepared incorporating the summaries of all functional budgets. It comprises of budgeted profit and loss account, budgeted balance sheet, budgeted production, sales and costs. The ICMA England defines a Master Budget as ‘the summary budget incorporating its functional budgets, which is finally approved, adopted and employed’. The master budget represents the activities of a business during a profit plan. This budget is also helpful in coordinating activities of various functional departments.

Fixed Budget and Flexible Budget

Flexible Budget: A flexible budget is defined as “a budget which, by recognizing the difference between fixed, semi variable and variable cost is designed to change in relation to the level of activity attained”. Flexible budgets represent the amount of expense that is reasonably necessary to achieve each level of output specified. In other words, the allowances given under flexibility budgetary control system serve as standards of what costs should be at each level of output.

Fixed Budget: A fixed budget, on the other hand is a budget which is designed to remain unchanged irrespective of the level of activity actually attained. In a fixed budgetary control, budgets are prepared for one level of activity whereas in a flexibility budgetary control system, a series of budgets are prepared one for each level of alternative production levels or volumes.

Fixed Budget	Flexible Budget
1. It does not change with actual volume of activity achieved. Thus it is known as rigid or inflexible budget.	It can be re-casted on the basis of activity level to be achieved. Thus it is not rigid.
2. It operates on one level of activity and under one set of conditions. It assumes that there will be no change in the prevailing conditions, which is unrealistic.	It consists of various budgets for different levels of activity.
3. Here as all costs like - fixed, variable and semi-variable are related to only one level of activity. So variance analysis does not give useful information.	Here analysis of variance provides useful information as each cost is analysed according to its behaviour.
4. If the budgeted and actual activity levels differ significantly, then the aspects like cost ascertainment and price fixation do not give a correct picture.	Flexible budgeting at different levels of activity facilitates the ascertainment of cost, fixation of selling price and tendering of quotations.
5. Comparison of actual performance with budgeted targets will be meaningless specially when there is a difference between the two activity levels.	It provides a meaningful basis of comparison of the actual performance with the budgeted targets.

Responsibility Accounting- Concept

- It is used to measure performance of divisions of an organisation rather than organisation as a whole.
- Responsibility Accounting is a system of control where responsibility is assigned for the control of costs. The persons are made responsible for the control of costs.
- Proper authority is given to the persons so that they are able to keep up their performance. In case the performance is not according to the predetermined standards then the persons who are assigned this duty will be personally responsible for it. In responsibility accounting the emphasis is on men rather than on systems.
- Responsibility Accounting collects and reports planned and actual accounting information about the inputs and outputs of responsibility centres”
- Responsibility Accounting must be designed to suit the existing structure of the organization.
- Responsibility should be coupled with authority. An organization structure with clear assignment of authorities and responsibilities should exist for the successful functioning of the responsibility accounting system. The performance of each manager is evaluated in terms of such factors.

Responsibility Accounting- Meaning & Definition

- Responsibility accounting is a system of management accounting under which accountability is established according to the responsibility delegated to various levels of management and a management information and reporting system instituted to give adequate feedback in terms of the delegated responsibility.
- Under this system, divisions or units of an organisation under a specific authority in a person are developed as responsibility centres & evaluated individually for their performance.

Essential Features of Responsibility Accounting

1. Inputs and Outputs or Costs and Revenues:

- The implementation and maintenance of responsibility accounting system is based upon information relating to inputs and outputs.
- The physical resources utilized in an organisation such as quantity of raw material used and labour hours consumed, are termed as inputs. These inputs expressed in the monetary terms are known as costs.
- Similarly, outputs expressed in monetary terms are called revenues.
- Thus, responsibility accounting is based on cost and revenue information.

2. Planned and Actual Information or Use of Budgeting:

- Effective responsibility accounting requires both planned and actual financial information.
- It is not only the historical cost and revenue data but also the planned future data which is essential for the implementation of responsibility accounting system.
- It is through budgets that responsibility for implementing the plans is communicated to each level of management.
- The use of fixed budgets, flexible budgets and profit planning are all incorporated into one overall system of responsibility accounting.

3. Identification of Responsibility Centres:

- The whole concept of responsibility accounting is focused around identification of responsibility centres.
- The responsibility centres represent the sphere of authority or decision points in an organisation.

In a small firm, one individual or a small group of individuals, who are usually the owners may possibly manage or control the entire organisation.

- However, for effective control, a large firm is, usually, divided into meaningful segments, departments or divisions. These sub- units or divisions of organisation are called responsibility centres.
- A responsibility centre is under the control of an individual who is responsible for the control of activities of that sub-unit of the organisation.
- This responsibility centre may be a very small sub-unit of the organisation, as an individual could be made responsible for one machine used in manufacturing operations, or it may be very big division of the organisation, such as a divisional manager could be responsible for achieving a certain level of profit from the division and investment under his control.
- However, the general guideline is that “the unit of the organisation should be separable and identifiable for operating purposes and its performance measurement possible”.

4. Relationship between Organisation Structure and Responsibility Accounting System:

- A sound organisation structures with clear-cut lines of authority—responsibility relationships are a prerequisite for establishing a successful responsibility accounting system.
- Responsibility accounting system must be so designed as to suit the organisation structure of the organisation.
- It must be founded upon the existing authority- responsibility relationships in the organisation.

Advantages of Responsibility Accounting

- Responsibility accounting establishes a robust mechanism for cost control
- To achieve the objectives of cost control, the organizational structure is re-assessed by the management to consider attribution of responsibility as well as engaging in power delegation
- Budgeting is put in place which helps in the comparison of actual achievement on the ground
- The awareness among designated personnel is enhanced, which is likely to lead to greater productivity. They will also be held accountable for their actions, and any deviation will necessarily call for an explanation
- Reporting structure and timings are facilitated because such items are excluded which is beyond the purview of individual responsibility of the designated personnel.

- It encourages managers to recognise the company's structure, determine who is responsible for what, and resolve issues.
- Because managers must explain the deviations for which they are accountable, it enhances their attention and awareness.
- It makes it easier to compare the accomplishments of pre-planned goals with real outcomes.
- Individual employees will feel more efficient as their efforts and accomplishments are evaluated.

Disadvantages of Responsibility Accounting

- There could be instances of individual interest and organizational interest to be at loggerheads. Such conflict is likely to create problems for policy implementation
- An organizational chart may not be possible to be established in such a manner where the grant of authority and the responsibility lines are clearly demarcated
- The policy implementation process is likely to experience the reactions from the designated person as well, which may eventually cause passive resistance. Such actions may negatively impact the organizational objectives
- The tool can only be effective if an outstanding reporting system is put in place
- In the absence of a sound structure of the organization, the responsibility centers cannot be clearly identified.

CONCEPT OF RESPONSIBILITY CENTRE:

Responsibility centre

- The main focus of responsibility accounting lies on the responsibility centres.
- A responsibility centre is a sub unit of an organization under the control of a manager who is held responsible for the activities of that centre.
- It is like a small business to achieve the objectives of a large organisation

1. Cost Centre

- o 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.
- o According to CIMA, London a cost centre is “a location person or equipment , for which costs maybe ascertained and used for purposes of cost control”
- o Responsibility in a cost centre is restricted to cost.
- o 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.
- o Cost centre managers have control over some or all of the costs in their segment of business, but not over revenues.
- o In manufacturing organisations, the production and service departments are classified as cost centre. Also, a marketing department, a sales region or a single sales representative can be defined as a cost centre.

2. Revenue Centre

- o It is a segment of the organisation which is primarily responsible for generating sales revenue.
- o 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.
- o The revenue centre manager will control the selling price, promotion mix and product mix
- o The performance of a revenue centre is evaluated by comparing the actual revenue with budgeted revenue, and actual marketing expenses with budgeted marketing expenses.
- o E.g. sales department

3. Profit Centre

- o Also called business centre
- o It is a segment of an organisation whose manager is responsible for both revenues and costs.
- o 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.
- o The managers are encouraged to act as if they were running their own separate business.
- o The main purpose of a profit centre is to maximise profit by making decisions relating to production volume, product mix, selling price, marketing strategy.
- o Profit centre managers aim at both the production and marketing of a product.

4. Investment Centre

- o It is responsible for both profits and investments.
- o The investment centre manager has control over revenues, expenses and the amounts invested in the centre's assets.
- o He also formulates the credit policy which has a direct influence on debt collection, and the inventory policy which determines the investment in inventory.
- o The manager of an investment centre has more authority and responsibility than the manager of either a cost centre or a profit centre.
- o Besides controlling costs and revenues, he has investment responsibility too. 'Investment on asset' responsibility means the authority to buy, sell and use divisional assets.
- o E.g. a new hotel being developed