

# [The controllability principle essay sample](https://assignbuster.com/the-controllability-principle-essay-sample/)

[](https://assignbuster.com/)[Business](https://assignbuster.com/essay-subjects/business/), [Management](https://assignbuster.com/essay-subjects/business/management/)

Central to the process of decision making is the concept of responsibility centers. Here, the principle of controllability states that the manager of a responsibility center is only accountable for the income, costs and investments of which he has control of (Atkinson, Banker, Young & Kaplan, 2001).

The case of a College Dean of Business who was held accountable for the performance of an English teacher assigned to teach business students, instead of the Dean of Arts and Sciences where the English language discipline for the whole university is serviced and supervised, has created organizational conflicts among teachers and Deans that ultimately affected the quality of instruction and employability of graduates for the university.

Performance of responsibility centers measured in terms of segment margins based on allocated revenues, cost and expenses create issues of unfairness. This can be avoided by establishing policy guidelines formulated, agreed upon and monitored by managers of affected responsibility centers. For example, how the various segments will determine allocation basis for sensitive expenses such as executive compensation straddling all units in the organization will be based on the most applicable cost drivers acceptable to all unit managers. The dynamics of the allocation basis under the management tool of transfer pricing should be fair and not arbitrary.

This brings the issue of accounting practices which may aid or impair managerial effectiveness. In general, accounting standards and principles serve to provide objectivity in measuring the performance of managers. Audited accounting data and information are irrefutable basis for performance measurement. However, accounting practices that are not supported or restated in terms of management accounting reports such as responsibility accounting and fair transfer pricing can be demotivating to managers whose performance cannot be measured in identical terms with other managers.

In accounting practice, budgets are the quantitative expression of the coordinative and proactive planning process that indicates how limited resources are to be utilized and maximized for a certain period to meet desired objectives (Garrison & Noreen, 2004) (Anthony & Govindarajan, 2003). Cash forecast, on the other hand, is a component of the planning processes that considers the effect of the environment on the liquidity or cash levels for a certain period which may vary from time to time. The key differences lie in the sense of formality and responsibility in a budget but not in a forecast.

Likewise, cash flows are financial statements that highlight the major activities that impact the levels of cash balances and provides specific information not provided by the balance sheet and income statement (Garrison & Noreen, 2004: 726). It is affected by the nature of operating ( current assets and revenue and expenditure cycle ), investing ( acquiring and disposing non-current assets) and financing (credits and equity transactions with lenders and shareholders during the period) and usually indicates the relative stability and liquidity of the company for the period. Cash flow projections are considered significant and critical to the company’s liquidity if it is reasonably accurate. Businessmen say that sales are good, profits nicer, but cash flow determines whether the business succeeds or fails.

Reference List

Anthony, R & Govindarajan, V., (2003). Management Control Systems , Budget Preparation ( pp. 410-411) 11 th International Edition, Singapore: Asia, MacGraw-Hill Education

Atkinson, A, Banker, R., Kaplan R., & Young, S. (2001). Management Accounting , Responsibility Centers and Financial Control (pp 529-535), 3 rd Edition, New Jersey: Prentice Hall International

Drury C. & Shisini H. (2005). Divisional Performance Measurement, An Examination of the Potential Explanatory Factors, London: The Chartered Institute of Management Accountants.

Garrison R. & Noreen, E. (2004). Managerial Accounting , How well am I? The Statement of Cash Flows, (pp. 726-761,) Tenth Edition, Singapore: McGraw-Hill Education