

Responsibility cost control system

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Assignment: Cost Modules Essay Cost management in China has been evolving over the past ten years due to influence by the foreign concepts of management accounting. This can be traced back to year 2001 where increased market openness, reduced government interference, and increased management autonomy were mandatory for China's accession to the World Trade Organization. This change in market condition has incentivized Chinese firms to improve their management accounting practices.

Subsequently, the traditional costing method is also facing a sudden threat by the influx of ABC/M, Target Costing, Responsibility Accounting, etc. Presented with new ideas, this essay will discuss the popular cost management accounting trend in China, specifically the responsibility cost control system. I will also compare the changes in the Chinese management accounting practices and give opinions on the possible future outlook of the cost and management accounting landscape.

According to the research on contemporary management accounting in China by Jason Zezhong Xiao and Rong-Ruey Duh, the most widely used techniques are, cost behavior analysis, cost allocation, responsibility accounting, and cost-volume-profit (CVP) analysis. On the other hand, the lowest levels of adoption are techniques like the activity-based costing/management, kaizen costing, standard costing, and environmental accounting. This result is gathered by providing the firms with 25 management accounting practices and asking them to feedback the extent to which they applied each of the 25 practices in the running of their businesses.

Results showed that the responsibility cost control system, together with CVP analysis, are among the most popular 'new' practices adopted by Chinese firms since market reformed. Specifically, I will discuss responsibility cost control system using the example of Han Dan Iron and Steel Company. Han Dan Iron and Steel Company was established in 1958 and was originally a state-owned iron and steel mill under the administration of government authority at provincial level. It introduced 'responsibility cost control system' in the beginnings of 1990s, and went public in the next half of that decade. There are four underlying principles for the responsibility cost control system. 1. Setting cost and profit targets that take into account market pressures 2. Assigning target costs to various levels of responsibility center 3. Evaluating performance based on fulfillment of the responsibility cost targets, and 4. Implementing a reward scheme with built-in incentive mechanisms.

To explain the first principle of responsibility cost control system using Han Dan Company, all 60 units and subsidiaries were regrouped and decentralized in accordance to the Company's operational goals into two main categories - producing divisions and servicing units. Han Dan Company has 13 primary producing divisions and within each is a design of multi-tier responsibility centers. This is crucial in the cost setting and profit targeting of responsibility cost control system and they are designed to be dependent on sales and demand, incorporating market pressure.

The assignment of target costs to the various levels of subdivisions is by a top-down approach. It is different from the traditional standard costing method and is in line with the above principle of taking into account market

pressure. The market prices are first determined and subsequently, target costs and profits will be just moving averages of the fluctuating market price. The third principle cannot hold without a good design and implementation governed by the DFA, the department that is also responsible to the evaluation of individual responsibility centers.

This principle focused mainly on the target costs and is the most important indicator of responsibility performance in the responsibility cost control system. All bonuses will be forfeited when a responsibility center fail to meet its cost targets, even if other targets are fulfilled. The reward system however, does acknowledge and encourage the achievement of other related responsibility standards such as production output, product quality, etc. beyond the cost targets even though it is a secondary subject to the 'cost-veto' mechanism illustrated above.

Although the responsibility cost control system is often compared to target costing, I feel that it is actually better than target costing due to the fact that it focuses more on actual results than forecast. Target costing on the other hand focuses more on forecast and new product planning, and extends cost management beyond the firm to include supply chain partners. Moreover, responsibility cost control system has proven great success in the case of Han Dan Company. It is an exemplary model for the government and business community in China to consider in other state-owned enterprises.

Looking forward, with China's market continuing to evolve and opening up to foreign ideas and companies, we can foresee it moving towards a market-oriented economic system where companies are more motivated to adopt management techniques to improve performance. However, the adoption

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does not guarantee efficiency and profitability if government forces it onto them without considering the unique business situation. Like Han Dan Company, Chinese firms should diffuse and develop innovative management techniques to suit their own needs and we will definitely see even better developments by Chinese firms in the future.

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