

Responsibility centers & segments

✓ Responsibility centers, and what each is accountable for:

- Cost center: costs
- Profit center: profit
- Revenue center: revenue
- Investment center: all + invested capital; judged on ROI and residual income

✓ Contribution margin = sales – total variable costs; $CM\% = \frac{CM \text{ per unit}}{\text{selling price}}$

✓ Controllable margin: revenues – controllable (direct, avoidable) costs; excludes allocated common costs

✓ Common-cost allocation: stand-alone (by independent usage) vs incremental (base user first, then incremental)

ROI, residual income & investment base

✓ $ROI = \frac{\text{operating income}}{\text{average invested capital}}$

A %, easy to compare; ignores risk and TVM; can drive short-termism

✓ Residual income = operating income – (average invested capital × required rate of return)

An absolute dollar amount; positive = above the required return; encourages any project earning above the hurdle, even if ROI falls; harder to compare across sizes

✓ Investment-base issues:

- Income measure: operating vs net income, non-recurring items
- Inventory: LIFO lowers the base → higher ROI when costs are rising
- Assets: historical cost inflates ROI and RI over time; fair value lowers them
- Shared assets need fair allocation

Transfer pricing

✓ Objectives: fair divisional evaluation, accurate cost allocation, tax compliance

✓ Methods: market price, cost-based (variable, full, cost-plus), negotiated, dual

✓ General rule: floor = variable (incremental) cost; ceiling = external market price

- Excess capacity → price near variable cost
- Full capacity → add opportunity cost

KPIs, balanced scorecard & profitability

✓ CSFs = elements essential to the strategy; KPIs = quantifiable metrics tracking the CSFs

✓ Balanced scorecard, 4 perspectives: financial, customer, internal process, learning & growth; a strategy map links them by cause and effect

✓ Profitability analysis: by product, customer, or segment; challenges = cost measurement, cost allocation, and investment/valuation measurement