



JWI 530: Financial Management I

Academic Submissions and Evaluations

Assignment 3: Management Accounting Case: West Island Products

Due Week 8, Day 7 (100 points)

The specific course learning outcomes associated with this assignment are:

- Apply key techniques and concepts in measuring the cost of producing goods and services.
- Apply management accounting concepts to identify and process relevant financial information for decision-making purposes.
- Use technology and information resources to research issues in financial management.
- Write clearly and concisely about financial management using proper writing mechanics.

Assignment:

West Island Products (WIP) is a divisionalized furniture manufacturer. The divisions are autonomous segments with each division responsible for its own sales, cost of operations, and equipment acquisition. Divisional performance is evaluated annually based on ROI. Each division serves a different market in the furniture industry. Because the markets and products of the divisions are so different, there have never been any transfers between divisions.

The Commercial Division of WIP, manufacturers furniture for the restaurant industry. The Commercial Division plans to introduce a new line of counter chair units featuring a cushioned seat. Roberta Katz, the Commercial Division manager, has discussed the manufacturing of the cushioned seats with Nathan Danielson of the Office Division. They both believe a cushioned seat currently made by the Office Division for use on its deluxe office stool could be modified for use on the new counter chair. Consequently, Katz asked Danielson for a price for 100-unit lots of the cushioned seats. The following conversation took place about the price to be charged for the cushioned seats.

Danielson: "Roberta, we can make the necessary modifications to the cushioned seat easily. The raw materials used in the new counter chair seat are slightly different and should cost about 10 percent more than those used in our deluxe office stool. However, the labor time should be the same because the seat fabrication process is the same. I would price the cushioned seat at our regular rate: full cost plus a 30 percent mark-up. According to my calculations, that would be \$2,053 per lot of 100 seats."

Katz: "That's higher than I expected, Nathan. I was thinking that a good price would be your variable manufacturing cost. After all, your fixed costs will be incurred regardless of this job. In addition, I have received a quote from one of the Commercial Division's regular suppliers to provide us with the counter seats at \$1,900 per lot of 100 seats."

Danielson: "Roberta, I am at full capacity. By making the cushioned seats for you, I have to cut my production of deluxe office stools. The labor time freed by not having to fabricate the frame and assemble the deluxe stool can be shifted to the production of the economy stool. I'd like to sell the cushioned seats to you at my variable cost, but I have excess demand for both products. I don't mind changing my product mix to the economy model and producing the cushioned seats for you as long as I don't change my division's overall profitability. Here are my standard costs for the two stools and a schedule of my manufacturing overhead." (See Exhibits 1 and 2.)

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- Katz:** "I guess I see your point, Nathan, but I don't want to price myself out of the market. In addition to pricing, I am also concerned about delivery. We'll need the counter seats within two weeks of placing our order or we risk losing some important potential customers. Our outside supplier claims that they can meet our timing needs."
- Danielson:** "Oh-oh. That lead-time is a bit short considering the production re-scheduling we need to do. I can't promise you a lead-time shorter than four weeks at the moment."
- Katz:** "There's quite a few issues that need to be addressed here, Nathan. As we have no previous experience in transferring goods between our divisions, I think we should speak with the controller at corporate headquarters before we can agree on a transfer price."

Exhibit 1 – Office Division Standard Costs and Prices

	Deluxe Office Stool	Economy Office Stool
Direct materials:		
Framing	\$ 7.35	\$ 6.50
Cushioned seat	6.40	—
Molded seat (purchased)	—	6.00
Direct Labor:		
Frame fabrication (0.5 hrs. @ \$7.50/hr.)	3.75	3.75
Cushion fabrication (0.5 hrs. @ \$7.50/hr.)	3.75	—
Assembly (0.5 hrs. @ \$7.50/hr.)	3.75	3.75
Manufacturing overhead (\$10.00/DLH)	15.00	10.00
Total standard cost	<u>\$ 40.00</u>	<u>\$ 30.00</u>
Selling price (including 30% mark-up)	<u>\$ 52.00</u>	<u>\$ 39.00</u>

Exhibit 2 – Office Division Manufacturing Overhead Budget

Overhead Item	Description	Amount
Supplies	Variable	\$ 370,000
Indirect labor	Variable	375,000
Supervision	Fixed	150,000
Power	Variable	180,000
Heat and light	Fixed	120,000
Property tax & insurance	Fixed	130,000
Depreciation	Fixed	1,100,000
Employee benefits	Variable	575,000
	Total overhead	<u>\$ 3,000,000</u>
	Capacity in direct labor hours (DLH)	<u>300,000</u>
	Overhead rate per direct labor hour	<u>\$ 10.00</u>

Required:

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Your goal is to examine this situation and recommend a course of action for Roberta Katz and Nathan Danielson.

1. Re-examine Nathan Danielson's calculation of a transfer (selling) price for the cushioned seats to the Commercial Division. Based on the information provided, determine/confirm the transfer price that would meet Danielson's objective regarding the profitability of the Office Division.
2. Discuss the pros and cons of each option (i.e., in-sourcing and out-sourcing). Include in your analysis what you believe the corporate controller is likely to recommend and why.
3. How would you suggest that the company handles such transfer disputes in the future (i.e., what policies would you suggest putting in place)? Make sure your recommendation includes financial policies around setting a transfer price range. Support your suggestion by examining the advantages and disadvantages of its adoption.

Grading:

Grades for this assignment will be based on answer quality, logic/organization of the paper, and language and writing skills, using the following rubric:

Assignment Points	Percentage	Grade
90 – 100	90% – 100%	A
80 – 89	80% – 89%	B
70 – 79	70% – 79%	C
0 – 69	0% – 69%	F

Points: 100	Assignment 3: Management Accounting Case: West Island Products			
Criteria	Unacceptable 0-69% F	Fair 70-79% C	Proficient 80-89% B	Exemplary 90-100% A
1. Re-examine Nathan Danielson's calculation of a transfer (selling) price for the cushioned seats to the Commercial Division. Based on the information provided, determine/confirm the transfer price that would meet Danielson's objective regarding the profitability of the Office Division. Weight: 50%	Did not submit or incompletely analyzed the transfer (selling) price.	Partially analyzed the transfer (selling) price.	Satisfactorily analyzed the transfer (selling) price.	Thoroughly analyzed the transfer (selling) price.
2. Discuss the pros and cons of each option (i.e., in-sourcing and out-sourcing). Include in your analysis what you believe the corporate controller is likely to recommend and why. Weight: 20%	Did not submit or incompletely analyzed the pro's and con's of each option.	Partially analyzed the pro's and con's of each option.	Satisfactorily analyzed the pro's and con's of each option.	Thoroughly analyzed the pro's and con's of each option.
3. How would you suggest that the company handles such transfer disputes in the future (i.e., what policies would you suggest putting in place)? Make your	Did not submit or incompletely analyzed recommendations	Partially analyzed recommendations for handling the transfer pricing	Satisfactorily analyzed recommendations for handling the	Thoroughly analyzed recommendations for handling the

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recommendations and include financial policies around setting a transfer price range. Support your suggestion by examining the advantages and disadvantages of its adoption. Weight: 20%	for handling the transfer pricing process.	process.	transfer pricing process.	transfer pricing process.
4. Clarity, writing mechanics, and formatting requirements. Weight: 10%	Multiple mechanics errors or much of the text is difficult to understand and fails to follow formatting instructions. The text does not flow.	Several mechanics errors make parts of the text difficult to understand; the text does not flow or the discussion fails to justify conclusions and assertions.	More than a few mechanics errors or text flows but lacks conciseness or clarity; assertions and conclusions are generally justified and explained.	Few mechanics errors; text flows and concisely and clearly expresses the student's position in a manner that rationally and logically develops the topics.