Chapter 14:

Problem 14-56

Winners circle inc manufactures medals for winners of athletic events an other contests. Its manufacturing plant has the capacity to produce 10,000 medals each month. Current month production is 7500 medals. The company normally charges 175 per medal. Varialbe costs and fixed costs for the current activity level of 75 percent of capacity are as follows

Winners Circle has just revieved a special one time order for the 2500 medals at 100 per medal for this particular order no variable marketing costs will be incurred Cathy Donato a management accountant with Winners Circle has been assigned the task of analyzing this order and recommending whether the company should accept or reject it. After examining the costs Donato suggested to her supervisor, Gerard PePenn who is the controller that they request competatitve bids from vendors for the raw materials as the current quote seems high. Lepenn insisted that the prices are in line with other vendors and told her that she was not to discuss her observations with anyone else. Donato later discovered that Lepenn is a brother in law of the owner of the current rw matieral suplly vendor .

1. Identify and explain the costs that will be relevant to Cathy Donatos analysis of the special order being considered by Winners Circle
2. Determine if Winners Circle should accept the special order. In explaining your answer compute both the new average unit cost and the incremental unit cost for the special order
3. Discuss any othe considerations that Donato should include in her analysis of the special order
4. What steps could Donato take to resolve the ethical conflict arising out of the controllers insistence that the company avoid competitive bidding?
5. Build a spreadsheet Construct an excel spreadsheet to solve requirement 2. Show how the solution will change if the sales price is 170.

Chapter 16:

Case 16-59

The board of education for the central catskill school district is considering the acquisition of several minibuses for use in transporting students to school. Five of the school districts bus routes are underpopulated, with the result that the full size buses on those routes are not fully utilized. After a careful study the board has dcided that It is not feasible to consolidate the these routes into fewer routes served by full size buses. The area in which the students live is too large for that approach since some students bus ride to school would exceed the state maximum of 45 minutes. The plan under consideration by the board is to replace five full size buses with eight minibuses each of which would cover a much shorter route than a full size bus. The bus drivers in this rural school district are part time employees whose compensation costs the school district 18,000 per year for each driver. In addition to the drivers compensation, the annual costs of operating and maintaining a full size bus amount to 50,000. In contrast the board projects that a minibus will cost only 20,000 annually to operate and maintain. A Minibus driver earns the same wages as a full size bus driver. The school district controller has estimated that it will cost the district 15,250 initially to redesign its bus routes, inform the public install caution signs in certain hazardous locations, and retrain its drivers. A minibus costs 27,000 whereas a full size bus costs 90,000. The school district uses straight line depreciation for all of its long lived assets. The board has two options regarding the five full size buses. First, the buses could be sold now for 15,000 each. Second the buses could be kept in reserve to use for field trips and out of town athletic events and ot use as backup vehicles when buses break down. Currently, the board charters buses from a private company for these purposes. The annual cost of chartering buses amounts to 30,000. The school district controller has estimated that this cost could be cut to 5,000 per year if the fi e buses were lept in reserve. The five full size buses have five years of useful life remaining, either as regularly scheduled buses or as reserve buses. The useful life of a new full size buses have five years ofuseful life remaining, either as regularly scheduled buses or as reserve buses. The useful life of a new minibus is projected to be five years also.

Central catskill school district uses a hurdle rate of 12 percent on all capital projects.

1. Think about the decision problem faced by the board of education. What are the boards two main alternatives?
2. One of these main alternatives has two options embedded within it. What are those two options?
3. Before proceeding check the hint given at the end of the chapter, which explains and diagrams the school boards alternatives. Suppose the board of education chooses to buy the minibuses. Prepare a net present value analysis of the two options for the five full size buses. Should these buses be sold now or kept in reserve?
4. From your answer to requirement 3, you know the best option for the board to choose regarding the full size buses if the minibuses are purchased. Now you can ignore the other option. Prepare a net present value analysis of the school boards two main alternatives (a) continue to use the full size buses on regular routes or (b) purchase the mini buses. Should the minibuses be purchased?
5. Compute the internal rate of return on the proposed minibus acquisition
6. What information given in this case was irrelevant to the school boards decision problem? Explain why the information was irrelevant.
7. Independent of requirments 1 – 6, suppose the NPV analysis favors keeping the full size buses. Michael Jeffries, the business manager for the central catskill school district was prepared to recommend that the board not purchase the minibuses. Before ding so however Jeffries ran into a long time friend at the racquet club. Peter Reynolds was the vice president for sales at a local automobile dealership form wich the minibuses wold have been purchased. Jeffries broke the bad news about his impending recommendation about the minibuses to his friend . The two talked for some time about the pos and cons of the minibus alternative. Finally Reynolds said, Michael, you and I go way back a long time. I know your not paid all that well at the school district. Our top financial person is retiring next year. How would you like to come work for the dealership? That’s pretty tempting Peter let me think it over was Jeffries Response. Sure Michael, take all the time you want. In the meantime, how about rethinking that minibus decision? Its no big dealt to you and I could sure use the business. But Peter I told you what the figures say about that , responded Jeffries. Come on Michael. What are friends for? Discuss the ethical issues in this situation. What should Michael Jeffries do?

Hint for case 16-59

The school boards two main alternatives are as follows (1) continue to use the five full size buses on regular routes or (2) purchase eight minibuses to cover the regular bus routes. Under alternative (2) the board has two options. The full size buses could be (a) sold now or (b) kept in reserve.

