Lessons

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### Module 1 Review

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[Next Week](https://www.coursera.org/learn/managerial-accounting-tools/home/week/2)

## Review Classmates: Module 1 Mini-Project

Review by July 13, 11:59 PM PDT

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| --- | --- |
| **Reviews** | 5 left to complete |

Assignments for Week 1

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Submitted on May 17, 2016

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## Part 1

For **each of the two decisions** you choose:

Describe a specific setting, the decision, decision alternatives, and any other information that would comprise an interesting and challenging problem.

**Make Or Buy Desicion:**  
  
**The make-or-buy decision is the action of deciding between manufacturing an item internally (or in-house) or buying it from an external supplier (also known as outsourcing). In a make-or-buy decision, the two most important factors to consider are cost and availability of production capacity.**  
  
**Costs for the make analysis**

* Direct materials
* Direct labor
* Manufacturing overhead (Variable production costs)
* Factory equipment lease
* Factory building rent
* Supervisor salaries (Fixed production costs)

**Cost factors for the buy analysis**

* Cost from supplier
* Factory equipment lease
* Factory building rent
* Supervisor salaries (Fixed production costs)

**HOW TO ARRIVE AT A MAKE OR BUY DECISION?**

* Carry out the quantitative analysis by comparing the expenses incurred in each option.
* Think about all the qualitative factors that may have a bearing on the decision to manufacture the products.
* Think about qualitative factors that may have a bearing on the decision to buy the products from external suppliers.
* Factor the qualitative aspects into the quantitative assessment so as to complete it
* Arrive at a final make-or-buy decision after considering both quantitative and qualitative factors. This would depend on the particular business and what it is doing so as to create profits.

Read the response to Part 1 and assign points below. Be sure to see the detailed rubric on the Instructions tab before assigning points.

* 0 pts - 0 Points: No answer, completely irrelevant answer.
* 5 pts - 5 points: Insufficient, incomplete, lacks supporting evidence.
* 7 pts - 7 points: passing, meets expectations.
* 9 pts - 9 points: Well above average, exceeds expectations.
* 10 pts - 10 points: Superior performance, excellent.

## Part 2

For **each of the two decisions** you choose:

Create a "deliverable" list for the person who would be completing the problem. This deliverable list should be comprised of (at least) two calculations and (at least) one qualitative discussion deliverable (i.e., requiring explanation, additional considerations, etc).

**Add OR Drop Decision:**  
  
**A decision whether or not to continue an old product line or department, or to start a new one is called an add-or-drop decision. An add-or-drop decision must be based only on relevant information.**  
  
**Relevant information includes the revenues and costs which are directly related to a product line or department. Examples of relevant information are sales revenue, direct costs, variable overhead and direct fixed overhead. Such decision must not be based on irrelevant information such as allocated fixed overhead because allocated fixed overhead will not be eliminated if the product line or department is dropped.**   
  
**When deciding if a company should drop an unprofitable segment, the company should create a segment contribution margin income statement. If the contribution margin is positive, the company should consider direct and common fixed costs, what to do with freed capacity, and the effect on sales of other products.**

Read the response to Part 2 and assign points below. Be sure to see the detailed rubric on the Instructions tab before assigning points.

* 0 pts - 0 Points: No answer, completely irrelevant answer.
* 5 pts - 5 points: Insufficient, incomplete, lacks supporting evidence.
* 7 pts - 7 points: passing, meets expectations.
* 9 pts - 9 points: Well above average, exceeds expectations.
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## Part 3

For **each of the two decisions** you choose:

In general, ensure that your exercise tests the person's knowledge related to the use of relevant information in decision making. That is, your exercise should contain some relevant and some "irrelevant" information, so that the person must distinguish between the two types of information. Further, your exercise should allow the person to demonstrate their understanding related to at least two of the following items:

* Opportunity costs
* Sunk costs
* Allocated fixed costs
* Fixed-cost per unit information

**Sunk Cost :**  
**A sunk cost is a cost that an entity has incurred, and which it can no longer recover by any means.Like:**

* Marketing study. A company spends $50,000 on a marketing study to see if its new auburn widget will succeed in the marketplace. The study concludes that the widget will not be profitable. At this point, the $50,000 is a sunk cost. The company should not continue with further investments in the widget project, despite the size of the earlier investment.
* Research and development. A company invests $2,000,000 over several years to develop a left-handed smoke shifter. Once created, the market is indifferent, and buys no units. The $2,000,000 development cost is a sunk cost, and so should not be considered in any decision to continue or terminate the product.
* Training. A company spends $20,000 to train its sales staff in the use of new tablet computers, which they will use to take customer orders. The computers prove to be unreliable, and the sales manager wants to discontinue their use. The training is a sunk cost, and so should not be considered in any decision regarding the computers.

**Allocated Cost:**  
  
A type of expense that is clearly associated with and so can be readily assigned to a certain business process, project or department. Examples of allocated cost types might include fabrication costs, sales costs, project management costs, and associated fixed costs.  
  
Cost allocation is important because it the process through which costs incurred in producing a certain product or rendering a certain service is calculated. If costs are not accurately calculated, a business might never know which products are making money and which ones are losing money. If cost are misallocated, a business may be charging wrong price to its customers and/or it might be wasting resources on products that are wrongly categorized as profitable.

Read the response to Part 3 and assign points below. Be sure to see the detailed rubric on the Instructions tab before assigning points.

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## Part 4

Finally, provide a solution for your exercise.

**Example of Make or Buy Decision:**  
  
**Quality Bikes, Inc., currently produces racing bikes. Management is interested in outsourcing production of these bikes to a reputable manufacturing company that can supply the bikes for $600 per unit. Quality Bikes incurs the following annual production costs to produce 2,000 racing bikes internally:**  
  
 **Per Unit Total Annual Cost at 2,000 Units**  
**Variable Production costs**  
**Direct Materials $400 $800,000**  
**Direct Labor 100 2,00,000**  
**Manufacturing Overhead 50 100,000**  
**Fixed Production Costs**  
**Factory building and equipment lease 180000**  
**factory Insurance 60000**   
**Production supervisors salary 70000**   
  
**----------------------------------------------------------------------------------------------------------------------------------**  
 **Total Production Costs $1,410,000**  
  
**Outsourcing production eliminates all variable production costs, the production supervisor’s salary, and factory insurance**  
**costs. Factory building and equipment lease costs will remain the same regardless of the decision to outsource or to produce**  
**internally.**  
  
  
 **Alternative 1 Alternative2 Differential Amount Alternative 1 is**  
 **(make internally) (buy from outside)**  
  
**Variable Costs:**  
**Cost to buy from Outside 0 $1200000 $1200000 lower**  
**Direct material 800,000 0 800,000 Higher**   
**Direct Labour 200,000 0 200,000 Higher**  
**Manufacturing Overhead 100,000 0 100,000 Higher**  
  
**Fixed Costs**  
**Factory and equipment lease 180,000 180,000 0 Higher**  
**Factory Insurance 60,000 0 60,000 Higher**  
**,Supervisors salary 70,000 0 70,0000 Higher**  
  
 **Total Production costs $1,410,000 $1,380,000 $30,000 Higher**  
  
  
**Buying the bikes from an outside supplier is the best alternative. This alternative results in total costs of $1,380,000, providing $30,000 in savings compared to the $1,410,000 cost of producing bikes internally .**  
  
 **Result of Outsourcing Production Of Racing Bikes**  
**Cost increase to buy from outside $1,200,000**  
**Direct material cost savings 800,000**  
**Direct labor cost savings 200,000**  
**Manufacturing overhead cost savings 100,000**  
**Factory insurance cost savings 60,000**  
**Supervisor's salary cost savings 70,000**  
**Cost Saving from Outsourcing $30,000**   
  
**\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\***  
**Example For Keep & Drop Decision**  
  
**A company has three products: Product A, Product B and Product C. Income statements of the three product lines for the latest month are given below:**  
  
**Product Line**   
  
 **A B C**  
  
**Sales $467,000 $314,000 $598,000**  
  
**Variable Costs 241,000 169,000 321,000**  
  
**Contribution Margin $226,000 $145,000 $277,000**  
  
**Direct Fixed Costs 91,000 86,000 112,000**  
  
**Allocated Fixed Costs 93,000 62,000 120,000**  
  
**Net Income $42,000 − $3,000 $45,000**  
  
**Use the incremental approach to determine if Product B should be dropped.**  
  
**Solution :**  
  
**By dropping Product B, the company will loose the sale revenue from the product line. The company will also obtain gains in the form of avoided costs. But it can avoid only the variable costs and direct fixed costs of product B and not the allocated fixed costs. Hence:**  
  
**If Product B is Dropped**   
  
**Gains:**   
  
Variable Costs Avoided $169,000  
Direct Fixed Costs Avoided $86,000  
 $255,000  
Less: Sales Revenue Lost $314,000  
Decrease in Net Income of the Company $59,000  
  
\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*

Read the response to Part 4 and assign points below. Be sure to see the detailed rubric on the Instructions tab before assigning points.

* 0 pts - 0 Points: No answer, completely irrelevant answer.
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Please share constructive comments about the responses. What is one strength of the submissions? What is one area of improvement that you would like to suggest?

Submit Review

### Comments

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