

# CASE REPORT

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You have just been hired as an accountant for the Australian Electronics Division of HighTech Incorporated. HighTech is a highly diversified organisation headquartered in Japan, with interests in healthcare, electronics, construction, insurance and shipbuilding, though most of these are mainly in Japan. The Australian Electronics Division is based in Kwinana, Western Australia and is run as a stand-alone business.

The Australian Electronics Division produces printed circuit boards, memory chips and processors. These are mainly used in alarm systems, however, some are also used in other products. The Printed Circuit Board (PCB) Department is part of the Australian Electronics Division and produces circuit boards mainly for use in alarm systems. However, there are other circuit boards that are produced for other electronic devices, but these make up a small percentage of total sales of the PCB Department.

Three of the circuit boards produced by the PCB Department make up the bulk of the department's sales: The first, HT Prime, has been the mainstay of the department for several years. The market for this board is very competitive and price sensitive. The second, HT Maximus, was a new board introduced two years ago. It is a medium range circuit board that had slightly more advanced features. This board has been used in alarm systems that could be partly modified by customers to suit their requirements. The third circuit board, HT Zenith, is a top-of-the-range circuit board that allowed full configuration of the alarm system by customers. This board incorporates the latest technology and the price matches the capabilities of the circuit board.

When you arrived at work for the first time, you were invited into a meeting that was being chaired by Nagasai Motoko, head of the Electronics Division. At the meeting you were introduced to Gemma Gooding (Finance Manager; also your immediate supervisor); Alistair Cook (Purchasing Manager); Dominic Chan (Sales Manager) and Joe Yarran (Production Manager).

"Before we begin," Nagasai started. "I would like to acknowledge our new accountant who will be sitting in on this meeting. There are several issues we need to discuss and having fresh ears and eyes may be good for us. Why don't you start with your issue, Alistair?"

## CASE REPORT

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- Alistair: "I have told you all before, you guys need to stop messing around with the numbers. I do not know how much material is needed and when it is needed if you keep changing the numbers."
- Joe: "Like I said, we produce what is required by Dom and his team. You can't blame me for the changes as Dom keeps changing his numbers!"
- Dominic: "It's not like I want to change the numbers. The market is constantly changing so we need to adjust the numbers accordingly. Furthermore, we have to keep the numbers realistic for my sales people, otherwise, they would not be motivated to achieve them."
- Gemma: "Hang on, Dom. I prepared the budget and these are based on the information you provided for me at the beginning of the year. It's not like it will change so drastically that we have to change the numbers all the time."
- Joe: "Which is what I keep saying!"
- Dominic: "Look, I don't like this ganging-up on me business. I am only trying to make sure that our targets are met and that our sales team is happy, so that they will keep selling for us. If I have to adjust the numbers, it's because I am being told that the numbers are not achievable. I know I gave Gemma some numbers at the beginning of the year, but it's not like I have a crystal ball. I am only trying to predict based on last year's numbers. How else would I be able to give you numbers? Do you want me to pluck them out of the air?"
- Nagasai: "Alright, relax. No one is ganging-up on you. I understand that you are giving Gemma numbers based on experience. However, there may be other factors that you should consider. No, don't shake your head at me. I will get our new accountant to write up in his report to us what else you need to consider when forecasting next year's numbers. Hopefully that will solve your problem Alistair."

## CASE REPORT

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Alistair: "Partially. I have another question that maybe someone could answer. I have been told that Jaymie Electronics will be shutting its doors next year and they are looking to get rid of Theolite, a material that we use. I know we still have stock of it, but I am thinking that if we can buy it now at a discounted price, then maybe we should just buy it first."

Joe: "Look mate, I know you are cosy with Mel from over there, but we do not really need that much Theolite. I know we use it but why should we get it before we even need it?"

Alistair: "Look, this has nothing to do with Mel. I am just trying to save us money. We are going to need to buy it sooner or later, we might as well buy it at a discount."

Gemma: "I am not sure, Alistair. It would be a bit of a stretch for our finances to buy material we do not need yet."

Nagasai: "Why don't we let our new accountant work out whether we should or not? Is there anything else Alistair? Nope? How about you then, Joe?"

Joe: "Well, I am not sure whether you have heard of this new method of costing called ABC. I am not sure what it is, but a lot of our competitors seems to be implementing it. Maybe Gemma can tell us something about it?"

Gemma: "Well, that's really putting me in a spot isn't it Joe? I know something about it but it has been ages since I learnt about it. Maybe our new accountant would be better suited to explain it to us?"

Nagasai: "There's no need for that here. It can be included in the report. Tell us what ABC is and how it works. Explain the benefits of this ABC as well as the limitations. It can't be all good. Give us a recommendation as to whether we should implement it or not and if we should, then how do we go about it. Alright? Now, Dominic, anything from you?"

## CASE REPORT

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Dominic: “We have already discussed my issue. I would like to know a bit more about how I should forecast my sales numbers, but we all know these numbers must be realistic.”

Nagasai: “Alright Dom, we get your point. Does anyone have anything else to add?”

Joe: “Yes, I have something else. As you know, we produce most of the components needed for our PCBs. However, I have just had an offer from MHLV to produce one of our parts, the MKA 1919, for us. I have calculated how much it currently costs us to make and it seems like the offer from MHLV is cheaper. I am just wondering if we should just outsource that? It would save us quite a bit.”

Nagasai: “Well, give those costings to our new accountant and see what we come up with. This can be included in the report for our next meeting. Alright, does anyone else have anything to add? If not, can you all please provide some more information after the meeting to our new accountant so that the report can be prepared?”

With that the meeting was concluded and you are left with Nagasai in the room. “Look, I know this is a bit much for you, but I hope you can do well. There is another issue I would like you to consider as well. As you heard, Alistair is seeing Mel from Jaymie Electronics. I am not sure whether his proposal to buy at a discounted price is for our good, or for his own good. I hope that nothing illegal is happening here. Can you include in your report if there is anything wrong with that transaction?”

Nagasai said.

“And, next year is starting to look pretty bad for us. There are a few major maintenance issues coming up next year and this will add to our costs. Do you think we can move those costs to this year as we are doing alright? There won’t be any impact on our overall performance for this year or next as it will still add up over the two years. So have a look and tell me what you think.”

## CASE REPORT

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You then left the meeting with Nagasai and headed to see Gemma. “Sorry to put you in a spot, but you should be more familiar with ABC considering you have just graduated and I have not seen this for like a million years. Remember to send Nagasai an email cover for your report as he is a stickler for procedure. Now go see Joe for the ABC information as well as that offer from MHLV,” Gemma said.

You then went to the Production Department and Joe is waiting in his office for you with some information. “Here are the current costs of our three PCBs (See below). We seem to be doing alright, though we could always sell more of everything!” Joe said. But the main issue is that we seem to be producing more and more of the Zenith. It’s the most complex PCB but there seems to be a very strong demand for it. We must be doing something right here! Prime’s sales looks to be dropping as Dom is always telling us to reduce production of Prime and focus more on Zenith.”

### Current per unit costs of PCBs

	<u>HT Prime</u>	<u>HT Maximus</u>	<u>HT Zenith</u>
Direct Materials	\$46	\$72	\$94
Direct Labour	\$26	\$26	\$13
Overhead	\$25	\$38	\$75
Cost per board	<u>\$97</u>	<u>\$136</u>	<u>\$182</u>

“And these are the costings for MKA 1919 (See below). We typically produce 50,000 units per month but we have the capacity to produce up to 70,000 units if required. MHLV’s offer for each unit is really very good. I seriously think we should accept it. At \$3.85 per unit it makes it really difficult for us to even come close. Right now, we are producing each MKA 1919 for \$5.16. Tell me why we should not accept MHLV’s offer? I am sure that you can see it makes sense and will ultimately save us money!”

## CASE REPORT

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	<b>MKA 1919</b> <b>(50,000 units)</b>
Direct Materials	\$ 125,000
Direct Labour	30,000
Manufacturing Overhead*	60,000
General and administrative overhead**	43,000
Total Costs	<u>258,000</u>

\* Manufacturing overhead is applied on the basis of direct labour costs.

Fixed overhead	75% of direct labour costs
Variable overhead	<u>125%</u> of direct labour costs
Manufacturing overhead rate	<u>200%</u> of direct labour costs

\*\* General and administrative overhead is applied at 20 percent of the total costs of direct material, direct labour and manufacturing overhead.

Looks like it is now time for you to get down to work!

### **REQUIRED:**

Prepare a report (no more than 10-pages) for Nagasai Motoko that addresses all the issues in the above exchanges.

Attach an email brief of your report to Nagasai by the due date.