**Text: Accounting for Decision Making and Control**

**Edition: 7e**

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**Problem #: 7-5**

**Avid Pharmaceuticals**

Avid, a small, privately held biotech pharmaceutical manufacturing firm; specializes in developing and producing a set of drugs for rare classes of cancers. Avid has two divisions that share the same manufacturing and research facility. The two divisions, while producing and selling two different classes of products to different market segments, share a common underlying science and related manufacturing processes. It is not unusual for the divisions to exchange technical know-how, personnel, and equipment. The following table summarizes their most current year’s operating performance:

|  |  |  |
| --- | --- | --- |
|  | **Division A** | **Division B** |
| Number of Employees | 80 | 20 |
| Plant Square footage (000) | 80 | 120 |
| Revenues (000) | $2,000 | $1,000 |
| Operating Expenses (000) | 600 | 500 |
| Operating Profits (000) | **$1,400** | **$500** |

Avid’s corporate overhead amounts to $900,000 per year. Management is debating various ways to allocate the corporate overhead to the two divisions. Allocation bases under consideration include: numbers of employees, plant square footage, revenues, operating expense, and operating profits. Each division is treated as a separate profit center with each manager receiving a bonus based on his or her division’s net income (operating profits less allocated corporate overhead).

Required:

1. For each of the five proposed allocation bases, compute Division A’s and Division B’s net income (operating income less allocated corporate overhead).
2. Recommend one of the five methods (or no allocation of corporate overhead) to allocate corporate overhead to the two divisions, be sure to justify your recommendation.