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Gourmet Specialty Coffee Company (GSCC) is a distributor and processor of different blends of

coffee. The company buys coffee beans from around the world and roasts, blends, and packages them

for resale. GSCC currently has 12 different coffees that it offers to gourmet shops in one-pound bags.

The major cost is raw materials; however, there is a substantial amount of manufacturing overhead in

the predominantly automated roasting and packing process. The company uses relatively little direct

labor.

Some of the coffees are very popular and sell in large volumes, while a few of the newer blends

have very low volumes. GSCC prices its coffee at full product cost, including allocated overhead, plus a

markup of 30 percent. If prices for certain coffees are significantly higher than market, adjustments are

made. The company competes primarily on the quality of its products, but customers are price-conscious

as well.

Data for the 20x5 budget include manufacturing overhead of $12,000,000, which has been allocated

on the basis of each product’s direct-labor cost. The budgeted direct-labor cost for 20x5 totals

$1,200,000. Based on the sales budget and raw-material budget, purchases and use of raw materials

(mostly coffee beans) will total $5,800,000.

The expected prime costs for one-pound bags of two of the company’s products are as follows:

**Jamaican Colombian**

Direct material ......................................................................................................... $2.90 $3.90

Direct labor ............................................................................................................. .40 .40

GSCC’s controller believes the traditional product-costing system may be providing misleading

cost information. She has developed an analysis of the 20x5 budgeted manufacturing-overhead costs

shown in the following chart.

**Activity Cost Driver Budgeted Activity Budgeted Cost**

Purchasing ........................ Purchase orders ................ 2,316 ................... $ 2,316,000

Material handling ............... Setups .............................. 3,600 ................... 2,880,000

Quality control ................... Batches ............................. 1,440 ................... 576,000

Roasting ............................ Roasting hours .................. 192,200 ................... 3,844,000

Blending ............................ Blending hours .................. 67,200 ................... 1,344,000

Packaging ......................... Packaging hours ................ 52,000 ................... 1,040,000

Total manufacturing-overhead cost ............................................................................................... $12,000,000

Data regarding the 20x5 production of Jamaican and Colombian coffee are shown in the following

table. There will be no raw-material inventory for either of these coffees at the beginning of the

year.

Budgeted sales ............................................................................... 2,000 lb. 100,000 lb.

Batch size ...................................................................................... 500 lb. 20,000 lb.

Setups ........................................................................................... 3 per batch 3 per batch

Purchase order size ........................................................................ 500 lb. 50,000 lb.

Roasting time ................................................................................. 1 hr. per 200 lb. 1 hr. per 200 lb.

Blending time ................................................................................. .5 hr. per 200 lb. .5 hr. per 200 lb.

Packaging time ............................................................................... .1 hr. per 200 lb. .1 hr. per 200 lb.

**Required:**

**1.** Using GSCC’s current product-costing system:

*a.* Determine the company’s predetermined overhead rate using direct-labor cost as the single

cost driver.

*b.* Determine the full product costs and selling prices of one pound of Jamaican coffee and one

pound of Colombian coffee.

**2.** Develop a new product cost, using an activity-based costing approach, for one pound of Jamaican

coffee and one pound of Colombian coffee.

**3.** What are the implications of the activity-based costing system with respect to:

*a.* The use of direct labor as a basis for applying overhead to products?

*b.* The use of the existing product-costing system as the basis for pricing?