Case Study

Drawem Company purchased Bildem Company three years ago. Prior to the acquisition, Bildem manufactured and sold electronic products to third-part customers. Since becoming a division of Drawem, Bildem now manufactures electronic components only for products made by Drawem’s Macon Division.

Drawem’s corporate management fives the Bildem Division management considerable latitude in running the division’s operations. However, corporate management retains authority for decisions regarding capital investments, product pricing, and production quantities.

Drawem has a formal performance evaluation program for all divisional management teams that relies substantially on each division’s ROI. Bildem division’s income statement provides the basis for the evaluation of its divisional management (See the following income statement)

The corporate accounting staff prepares the decision’s financial statements. Corporate general services costs are allocated on the basis of sales dollars, and the computer department’s actual cost are apportioned among the divisions on the basis of use. The net division investment includes division fixed assets at net book value (cost less depreciation), division inventory, and corporate working capital apportioned to the divisions on the basis of sales dollars

Required:

1. Discuss Drawem Company’s financial reporting and performance evaluation program as it relates to the responsibilities of Bildem Division.
2. Based on the response to requirement (a), write a memo to management recommending appropriate revisions of the financial information and reports used to evaluate the performance of Bildem’s divisional management. If revisions are not necessary, explain why.

DRAWEM COMPANY

Bildem Division

Income Statement

For the year Ended June 30

(in thousand)

Sales Revenue $8,000

Cost and expenses:

Product Cost:

Direct material $1,000

Direct labor 2,200

Manufacturing overhead 2,600

Total $5,800

Less: Increase in inventory 700 5,100

Engineering and research 240

Shipping and receiving 480

Division administration:

Manager’s office $420

Cost management 80

Human services 164 664

Corporate cost:

General services $460

Computer 96 556

Total costs and expenses $7,040

Divisional operating profit $960

Net plant investment $3,200

Return on investment 30%