**Week 3 Hand-in Assignment**

For this assignment you will need to read the information provided in Exercise 5.8 of the textbook. This exercise relates to a company that manufactures three types of refrigerators. As the management accountant for this business, you have been asked by your boss to compute two separate costs for each line of refrigerator and then complete a detailed analysis.  
 After you have read the information provided in the textbook, complete the following:

* Calculate for each product the full cost and selling price determined by:
  + The original costing method
  + The activity-based costing method

Once you have the figures computed, prepare a detailed report for your boss that includes a discussion of the following information:

* + An analysis of implications involved with each of the two costing systems and subsequent price differences.
  + An analysis of each costing system, including a recommendation of which cost system you would recommend or any changes you would suggest to the pricing strategy.
  + An analysis of the business/strategic options that exist for your organisation in light of the new information, including possible pricing strategies.

The assignment should be prepared as a concise business report to your supervisor that includes both the figures computed and the analysis of the situation. Your written report should be approximately 2–3 pages in length; detailed quantitative comparisons and analyses can be attached in appendices.

**Exercise-5.8**

A business manufactures refrigerators for domestic use. There are three models: Lo, Mid and Hi. The models, their quality and their price are aimed at different markets. Product costs are computed on a blanket (business-wide) overhead-rate basis using a labour-hour method. Prices as a general rule are set based on cost plus 20 per cent. The following information is provided:

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Lo Mid Hi

Material cost (£/unit) 25 62.5 105

Direct labour hours (per unit) 1/2 1 1

Budget production/sales (units) 20,000 1,000 10,000

The budgeted overheads for the business amount to £4,410,000. Direct labour is costed at £8 an hour. The business is currently facing increasing competition, especially from imported goods. As a result, the selling price of Lo has been reduced to a level that produces a very low profit margin. To address this problem, an activity-based costing approach has been suggested. The overheads are examined and these are grouped around main business activities of machining (£2,780,000), logistics (£590,000) and establishment (£1,040,000) costs. It is maintained that these costs could be allocated based respectively on cost drivers of machine hours, material orders and space, to reflect the use of resources in each of these areas. After analysis, the following proportionate statistics are available in relation to the total volume of products:

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Lo Mid Hi

Machine hours 40 15 45

Material orders 47 6 47

Space 42 18 40

**Required:**

(a) Calculate for each product the full cost and selling price determined by

1- the original costing method

2- the activity-based costing method.

(b) What are the implications of the two systems of costing in the situation given?

(c) What business/strategic options exist for the business in the light of the new information?