15.514 Summer 2003

Session 18
Moving Beyond ABC

Objectives
1. Reinforce knowledge of Activity-Based Costing methods
2. Make the linkage between the economics of a firm's investment decision and how that investment is reflected in product costs

Game Plan & Class Pedagogy
   Case discussion

Reading Assignment
   CP: One Cost System Isn't Enough
           Seligram ETO (case)

Class Preparation Questions
·   Can be completed in small groups.
·   ***Problem Set 5*** due at the start of class. Hand in written answers to questions 1, 2, 4, and 5 at the start of class. Your answers to questions 3 and 6 need not be handed in, but you should discuss them with your group prior to the class discussion.
·   Each team member is advised to keep a copy of the group's answers for use during the class discussion

1. What business decisions at Seligram does the cost system support? In this context, what caused the existing cost system at Seligram (ETO) to fail?
2. Calculate the reported costs of the five components described in Exhibit 6 under:
   a.   the existing system,
   b.   the system proposed by the accounting manager, and
   c.   the system provided by the consultant.
3. Explain conceptually (and briefly) the dynamics that cause the movements you see in the costs calculated above. For example, why do costs for certain components increase when moving from alternative (a) to (b) but decrease from (b) to (c), while other costs increase from (a) to (b) to (c)?
4. Which of the three cost systems do you think is most appropriate? Why? What are some potential disadvantages of the system you would recommend?
5. Would you treat the new machine as a separate cost center or as part of the main room? Why? If you were to treat it separately, how would you allocate its costs?
6. Use the course framework and challenges to further analyze the case.
   a.   What is the accounting decision?
   b.   Describe the related economic activity.
   c.   What users are affected by the accounting decision?
   d.   What factors influence the decision?
   e.   What decisions are users making that depend on the accounting decision?
   f.   What are the consequences of users' decisions on Seligram?
   g.   What real-life computation challenge is related to the accounting decision?

Note: To answer question 5, you may need to be familiar with the Double-Declining Balance (DDB) approach to determining annual depreciation charges. Here's all you need to know: The new machine has a purchase price of $2MM, an 8-year life, and no salvage value. Hence, DDB will result in depreciation of $500K, $375K, $281.25K, and $210.9K in years 1 through 4, respectively. For each of years 5 through 8, depreciation would be $158.2K.