**Module 3 – Case Assignment Question**

**TRANSFER PRICING AND RESPONSIBILITY CENTERS**

**Assignment Overview**

**Coffee Maker's Incorporated (CMI)**

Three divisions of a CMI are involved in a dispute. Division A purchases Part 101 and Division B purchases Part 201 from a third division, C. Both divisions need the parts for products that they assemble. The intercompany transactions have remained constant for several years.

Recently, outside suppliers have lowered their prices, but Division C refuses to do so. In addition, all division managers are feeling the pressure to increase profit. Managers of divisions A and B would like the flexibility to purchase the parts they need from external parties at a lower cost and increase profitability.

The current pattern is that

* Division A purchases 2,700 units of product part 101 from Division C (the supplying division) and another 1,300 units from an external supplier.
* Division B purchases 1,100 units of Part 201 from Division C and another 700 units from an external supplier.
* Note that both divisions A and B purchase the needed supplies from both the internal source and an external source at the same time.

The managers for divisions A and B are preparing a new proposal for consideration.

* Division C will continue to produce Parts 101 and 201. All of its production will be sold to Divisions A and B. No other customers are likely to be found for these products in the short term, given that supply is greater than demand in the market.
* Division A will buy 2,000 units of Part 101 from Division C at the existing transfer price; and
* 2,000 units from an external supplier at the market price of $900 per unit.
* Division B will buy 900 units of Part 201 from Division C at the existing transfer price; and
* 900 units from an external supplier at $1,800 per unit.

**Division C Data Based on the Current Agreement**

|  |  |  |
| --- | --- | --- |
| **Part** | **101** | **201** |
| Annual volume (units) | 2,700 | 1,100 |
| Transfer price/unit | $1,000 | $2,000 |
|  |  |  |
| Variable expenses/unit | $700 | $1,200 |

The fixed overhead for Division C is $1,200,000.

**Case Assignment**

**Required:**

**Computations (use Excel)**

* Set up a table similar the one below to compute the difference between the current situation and the proposal for Divisions A and B.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Division A** | | | | | | |
|  | **Current Situation** | | | **Proposal** | | |
|  | **No. of Units** | **Purchase Price** | **Total Purchases** | **No. of Units** | **Purchase Price** | **Total Purchases** |
| Internal purchases | 2,700 |  | $ | 2,000 |  | $ |
| External purchases | 1,300 |  |  | 2,000 |  |  |
|  |  |  |  |  |  |  |
| Total cost for Part 101 |  |  | $ |  |  | $ |
|  |  |  |  |  |  |  |
| Savings to Div. A |  |  |  |  |  | $ |

* Compute the operating income for Division C under the current agreement and the proposed agreement.
* Is the revised agreement a good idea? Support your answer with computations.

**Memo (use Word)**

Write a 4- or 5-paragraph memo to the division manager explaining the analysis performed. Start with an introduction and end with a recommendation. Each of the four or five paragraphs should have a heading.

**Short Essay (use Word)**

Start with an introduction and end with a summary or conclusion. Use headings.

Evaluate and discuss the implications of the following transfer pricing policies:

* Transfer price = cost plus a mark-up for the selling division
* Transfer price = fair market value
* Transfer price = price negotiated by the managers

Why is transfer pricing such a significant issue both from a financial and managerial perspective?

**Assignment Expectations**

Each submission should include two files: (1) An Excel file and (2) a Word document. The Word document shows the memo first and short essay last. Assume a knowledgeable business audience and use required format and length. Individuals in business are busy and want information presented in an organized and concise manner.

Double space

APA Format

Reference credible sources only

The following resources are **not** **acceptable** for this course, keep in mind, there are many others:

* Wikipedia.com
* Ehow.com
* About.com
* [Smallbusiness.chron.com](http://smallbusiness.chron.com/)
* Diffen.com
* [Yourbusiness.azcentral.com](http://yourbusiness.azcentral.com/)
* Investopedia.com
* Boundless.com and Lumen
* Course hero
* Chegg