

Relevant Costing

1. Part O43 is used in one of Scheetz Corporation's products. The company's Accounting Department reports the following costs of producing the 6,000 units of the part that are needed every year.

	Per Unit
Direct materials	\$8.20
Direct labor.....	\$6.90
Variable overhead	\$1.80
Supervisor's salary	\$4.00
Depreciation of special equipment.....	\$8.80
Allocated general overhead.....	\$1.70

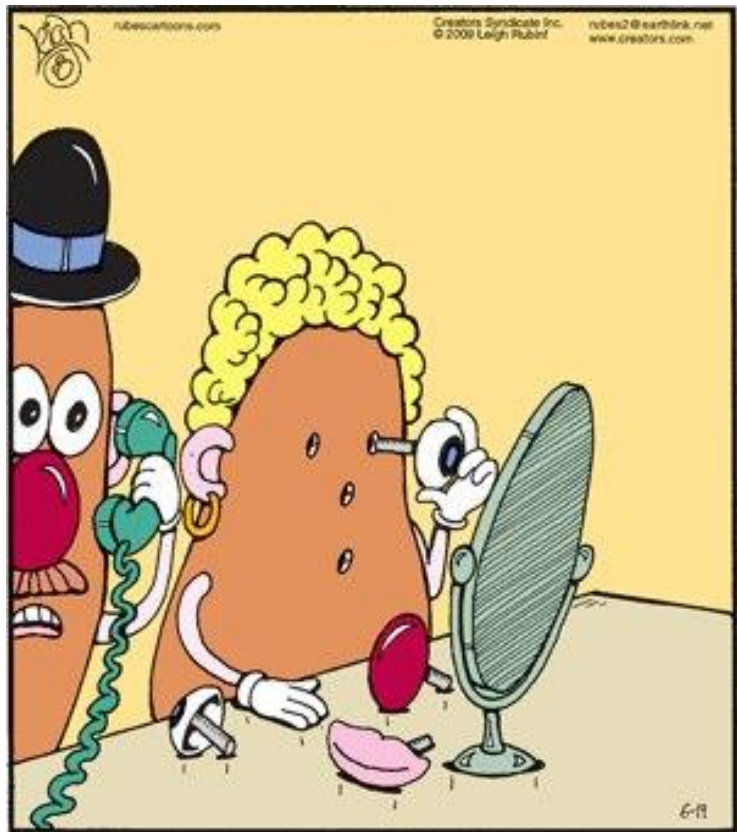
An outside supplier has offered to make the part and sell it to the company for \$26.40 each. If this offer is accepted, the supervisor's salary and all of the variable costs, including direct labor, can be avoided. The special equipment used to make the part was purchased many years ago and has no salvage value or other use. The allocated general overhead represents fixed costs of the entire company. If the outside supplier's offer were accepted, only \$1,000 of these allocated general overhead costs would be avoided.

Required:

- a. Prepare a report that shows the effect on the company's total net operating income of buying part O43 from the supplier rather than continuing to make it inside the company.
- b. Which alternative should the company choose?

2. Bowditch Corporation

purchases potatoes from farmers. The potatoes are then peeled, producing two intermediate products-peels and depeeled spuds. The peels can then be processed further to make a cocktail of organic nutrients. And the depeeled spuds can be processed further to make frozen french fries. A batch of



"I'm afraid the Mrs. can't come to the phone right now. I'll have her call you back as soon as she's done putting on her face."

potatoes costs \$37 to buy from farmers and \$14 to peel in the company's plant. The peels produced from a batch can be sold as is for animal feed for \$22 or processed further for \$13 to make the cocktail of nutrients that are sold for \$40. The depeeled spuds can be sold as is for \$37 or processed further for \$21 to make frozen french fries that are sold for \$53.

Required: a. Assuming that no other costs are involved in processing potatoes or in selling products, how much money does the company make from processing one batch of potatoes into the cocktail of organic nutrients and frozen french fries? Show your work!

b. Should each of the intermediate products, peels and depeeled spuds, be sold as is or processed further into an end product? Explain.

