

# Wilkerson case solutions essay sample

[Finance](#)



1. Describe in words how costs are assigned in the Wilkerson's current costing system. Discuss the pros and cons of this system.

Wilkerson uses a simple traditional cost accounting system in which each unit of product is charged for direct material, direct labor and overhead costs.

Material cost is based on the prices paid for component under annual purchasing agreements. Labor cost is charged to products based on the standard run times for each product. Labor rates, including fringe benefits, were \$25 per hour. The overhead costs are allocated to products as a percentage of production-run direct labor cost. Currently, the overhead rate is 300% of production-run direct labor cost.

The current cost accounting system is consistent with traditional costing system required for external financial reporting. Traditional costing is attractive to financial reporting because it better matches costs with revenues. All manufacturing costs are assigned to products in order to properly match the costs of producing units of product with their revenues when they are sold. Financial reporting standards explicitly require companies to use traditional costing for external reporting purposes.

However, traditional cost accounting methods suffer from several defects that can result in distorted costs for decision-making purposes. All manufacturing costs, even those that are not caused by any specific product, are allocated to products. Nonmanufacturing costs that are caused by products are not assigned to products. Additionally, traditional methods tend to place too much reliance on unit-level allocation bases such as direct labor

and machine-hours. This results in overcosting high-volume products and undercosting low-volume products and can lead to mistakes when making decisions.

2. Compute Activity-Based Costing product costs using 1) actual cost driver rates, and 2) capacity-based cost driver rates. Which of these approaches is appropriate for Wilkerson and why?

From the results of Activity Based Costing and Capacity based costing methods, we see that Wilkerson shows a lower cost based from the ABC method. It is more appropriate for Wilkerson to use the ABC method since it shows a more realistic per unit cost based on different level of activities. This may allow them to find ways to be more competitive on product pricing in the market.

3. What managerial actions are indicated by the activity based costing system?

From the activity based costing system the management will be able to see the products cost structure and be able identify activities that would benefit from process improvements. When used in this way, activity-based costing is referred to as activity-based management. Management can focus on which activities to eliminate waste, decrease processing time, and/or reduce defects.

The first step in any improvement program is for the management to decide what to improve. The products cost computed in activity-based costing can provide valuable clues concerning where there is waste and opportunity for

improvement. For example, looking at the Pumps and Flow Controller, managers at Wilkerson may conclude that the company spends far more on receiving and production control, and packaging and shipping activities that adds no value to the products. As a consequence, they may target their process improvement efforts toward these areas. Improvements on these areas could enable the company to gain competitive edge on pricing these products.

4. Describe the additional “ accounting” effort that Wilkerson would need to do to on a regular monthly basis in order to obtain the information shown in Exhibit 4. Estimate the cost of this additional “ accounting.” To continue to obtain the information shown in Exhibit 4 on a regular monthly basis would require much more effort from the Wilkerson accounting team. Similar to what was already done, Wilkerson will need to run a small task force on a monthly basis so that data concerning numerous activity measures are collected, checked, and entered into the system. This will be necessary to appropriately allocate various overhead costs to individual products instead of traditionally treating overhead as a period cost. Although the activity based costing method can provide more accurate information about individual product or services, the organization should expect to have increased costs due to additional research efforts to collect and appropriately allocate overhead costs. We estimate that the additional effort associated with activity based costing system can increase accounting cost by approximately 25%.