

World case

Business



Body Products Division of World Wide Drugs Ahmed Diba is the controller of the Body Products Division of World Wide Drugs (WWD). It is located in Winnipeg, which is the headquarters of WWD. Diba is helping develop a proposal for a new product to be called Vital Hair.

This product is a cream to be rubbed on the scalp to restore hair growth. Cheryl Kelly, president of the division and Diba are scheduled to make a presentation to the WWD executive committee on the expected profitability of Vital Hair.

The fixed costs associated with the development, production and marketing of Vital Hair are \$24, 000, 000. Each customer will pay a doctor \$96 per monthly treatment, of which \$66. 00 is paid to WWD.

Diba estimates WWD's variable costs per treatment to be \$26. 40. Included in this \$26. 40 is \$9. 60 for potential product litigation costs. Kelly is livid at Diba for including the \$9.

60 estimate. She argues that it is imperative to get the R and D funds approved (and quickly) and that any number that increases the breakeven point reduces the likelihood of the Vital Hair project being approved.

She notes that WWD has had few successful lawsuits against it, in contrast to some recent “horrendous” experiences of competitors with breast implant products. Moreover, she is furious that Diba put the \$9. 60 amount in writing. “How do we know there will be any litigation problem?” She suggests Diba redo the report excluding the \$9.

60 litigation risk cost estimate. “ Put it on the chalkboard in the executive committee room, if you insist, but don’t put it in the report sent to the committee before the meeting.

You can personally raise the issue at the executive committee meeting and have a full and frank discussion. ” Diba takes Kelly’s “ advice”. He reports a variable cost of \$16. 80 per treatment in the proposal.

Although he feels uneasy about this, he is comforted by the fact that he will flag the \$9. 60 amount to the executive committee meeting in his forthcoming oral presentation. One month later, Kelly walks into Diba’s office.

She is in a buoyant mood and announces she has just come back from an executive committee meeting that approved the Vital Hair product proposal. Diba asks why he was not invited to the meeting.

Kelly says the meeting was held in Toronto, and she decided to save the division money by going alone. She then says to Diba that it “ was now time to get behind the new venture and help make it the success the committee and her team members believe it will be. ” Required – What is the breakeven point (in units of monthly treatments) when WWD’s variable costs (a) include the \$9. 60 estimate? and (b) exclude the \$9. 60 estimate for potential product litigation costs? 2 – Should Diba have excluded the \$9. 60 estimate in his report to the executive committee of WWD? Explain your answer.

3 – If you were Diba, what would you do in response to Kelly’s decision to make the Vital Hair presentation on her own? Selected case from Horngren, Cost Accounting, 4th Canadian Edition
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