

Negotiated transfer pricing essay

[Business](#), [Accounting](#)



Negotiated transfer pricing Negotiated transfer pricing depends to a large extent on the degree of autonomy accorded to the divisions. Where there is external influence from top management the process of determining the transfer price between departments will be hampered.

Sometimes the top management intervenes since the transfer price set may maximize profit for one division while the profit of the company as a whole is not maximized i. e. benefiting one division at the expense of the company's welfare. The negotiated transfer price will depend to a large extent on negotiation skills and abilities of managers however other factors such as the market price of the product and cost of both the selling and buying division also play a major role in determination of transfer price. The selling division will only agree to the transfer when their profit increases as a result of transfer.

On the other hand the buying division can only agree to a transfer price which leads to an increase in profit. Where the transfer price is below the cost incurred by the selling division a loss will occur and hence the selling division will not accept that transfer price. On the other hand where transfer price is set too high the buying division will hardly make any profit, therefore the negotiated transfer price has a lower limit as determined by the selling division situation and the upper limit as determined by the buying division situation. The actual transfer price falls in between the two limit and will be determined by negotiation skills and abilities of negotiators (Kachelmeier and Towry, 2002). ABC and cost based transfer pricing Activity based costing (ABC) is best suited for cost based transfer pricing since it is able to objectively assign costs. ABC first identifies the cost of various activities then

allocate these cost to product based on product use of activity. In addition ABC is able to identify areas with high overhead cost and direct attention to reduce these costs or charge more for costly product.

ABC also helps in controlling cost at departmental level and individual level. Where ABC is adopted in organization it helps to identify unnecessary cost therefore making sure that the cost passed from one division to the other does not include cost relating to ineffective and inefficient operation of a single division for instance wage paid to idler workers (Sahay, 2003). Reference: Sahay, SA 2003, ' Transfer Pricing Based on Actual Cost.' Journal of Management Accounting Research, vol. 15, pp177-192.

Kachelmeier, SJ, and Towry, KL 2002, ' Negotiated Transfer Pricing: Is Fairness Easier Said than Done?' The Accounting Review, vol. 77, pp571-593.