Information systems corporation: transfer prices and goal congruence

Business, Company

The plant's costs for the semiconductors are higher than the competitor's market prices since its manufacturing costs are primarily fixed. This means that the cost per unit depends on how much is produced. The more semiconductors produced, the lower the cost per unit will be. On the reverse, the lesser the units produced, the higher the cost per unit will be. With the influx of high quality semi-conductors from the non-US companies with a price at or below that of the Semiconductor division, the product divisions began buying from external sources instead of purchasing within the company.

Since the production of the Semiconductor division is responsive to the demand for its products, it lessened its production as the demand declined resulting to a higher cost per unit for the semiconductors produced. Question 2: The controller should consider encouraging the product divisions to purchase from the Semiconductor division up to the latter's unused capacity and purchasing the rest from external suppliers since this provides for better goal congruence. Since the Semiconductor division is operating with an unused capacity, it will not incur additional costs to accommodate such orders.

The production divisions will even be helping the Semiconductor division to lower its cost per unit. Also since it is an interdivisional transfer, it has no net effect on Information Systems Corporation as a whole. Withrespectto the other needed quantities, it would better serve the interest of the company if the production divisions purchase from external suppliers who offer lower prices since in such a case, the Semiconductor will need to incur additional costs to accommodate the extra orders.

Compared to the present scenario where the production division managers purchase all the standard semiconductors from external suppliers which results to sub-optimization, or the situation that transpires when managers do not act in the best interests of the company as a whole (Garrison & Noreen, 2000), the proposed alternative is more beneficial for the Information Systems Corporation as a whole. In connection with this suggestion, the company should consider revising its policy of evaluating its profits centers on profitability alone by taking into consideration other factors such as the above mentioned.

Question 3: All transfer pricing methods has its share of its disadvantages be it negotiated, at cost or at market price. For the case of Information Systems Corporation, the recommended method would be the negotiated transfer prices. This method maintains the independence of the divisions consistent with the spirit of decentralization and is also conducive to more informed managers with regard to the costs and benefits of the transfer to the Information Systems Corporation as a whole (Garrison & Noreen, 2000).

Given that in committing to buy RAMS from the Semiconductor division the production division managers are not assured that the cost and price will not increase later should the selling division fail to meet the planned volumes or its cost objectives, coupled with the reasonable assumption that both divisions will act to maximize their respective profits, the negotiated transfer pricing best provides for better goal congruence.

Both the selling and purchasing divisions will be acting in the best possible manner for their respective segments since they are being evaluated as profit centers at the same time the company's overall goal is observed at their levels, resulting to an overall benefit for Information Systems Corporation. Reference Garrison, R. H. , & Noreen, E. W. (2000). Managerial Accounting Ninth Edition. United States of America: Irwin McGraw-Hill.