

Lenko products essay sample



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“ Don’t tell me we’ve lost another bid!” exclaimed Sandy Kovallas, president of Lenko Products, Inc. “ I’m afraid so,” replied Doug Martin, the operations vice president. “ One of our competitors underbid us by about \$10, 000 on the Hastings job.” “ I just can’t figure it out,” said Kovallas. “ It seems we’re either too high or get the job or too low to make any money on half the jobs, we bid anymore. What’s happened?”

Lenko Products manufactures specialized goods to customers’ specifications and operates a job-order costing system. Manufacturing overhead cost is applied to jobs on the basis of direct labor cost. The following estimates were made at the beginning of the year:

Department

Cutting

Machining

Assembly

Total Plant

Direct labor

\$300, 000

\$200, 000

\$400, 000

\$900, 000

Manufacturing overhead

\$540, 000

\$800, 000

\$100, 000

\$1, 440, 000

Jobs require varying amounts of work in the three departments. The Hastings job, for example, would have required manufacturing costs in the three departments as follows:

Department

Cutting

Machining

Assembly

Total Plant

Direct materials

\$12, 000

\$900

\$5, 600

\$18, 500

Direct labor

\$6, 500

\$1, 700

\$13, 000

\$21, 200

Manufacturing overhead

The company uses a plantwide overhead rate to apply manufacturing overhead cost to jobs.

Required:

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1. What is the problem at Lenko?

Lenko is not getting bids.

2. Assuming that the use of a plantwide overhead rate:

a. Compute the rate for the current year.

$$\$1,440,000 / \$900,000 = 1.6$$

b. Determine the amount of manufacturing overhead cost that would have been applied to the Hasting job. $1.6 * \$21,200 = \$33,920$

3. Suppose that instead of using a plantwide overhead rate, the company had used a separate predetermined overhead rate in each department.

Under these conditions: a. Compute the rate for each department for the current year. Cutting- $\$540,000 / \$300,000 = 1.8$

$$\text{Machining- } \$800,000 / \$400,000 = 2$$

b. Determine the amount of manufacturing overhead cost that would have been applied to the Hasting job. 4. Explain the difference between the manufacturing overhead that would have been applied to the Hasting job using the plantwide rate in question 2(b) and using the departmental rates in question 3(b). 5. Assume that it is customary in the industry to bid jobs at 150% of total manufacturing cost (direct materials, direct labor, and applied overhead). What was the company's bid price on the Hasting job? What would the bid price have been if department overhead rates had been used apply overhead cost?

Plantwide Rates Used

Cutting

Machining

Assembly

Total Plant

Direct Materials

\$12, 000

\$900

\$5, 600

\$18500

Direct Labor

\$6, 500 * 1. 6

\$1, 700 * 1. 6

\$13, 000 * 1. 6

\$21, 200 * 1. 6

Manufacturing Overhead

\$10, 400

\$2, 720

\$2, 080

\$33, 920

Total Manufacturing Overhead

\$28, 900

\$5, 320

\$39, 400

\$73, 620 * 1. 5

Company's Bid Price

\$110, 430

Departmental Rates Used

Cutting

Machining

Assembly

Total Plant

Direct Materials

\$12, 000

\$900

\$5, 600

\$18500

Direct Labor

\$6, 500 * 1. 8

\$1, 700 * 4

\$13, 000 * 0. 25

\$21, 200

Manufacturing Overhead

\$11, 700

\$6, 800

\$3, 250

\$21, 750

Total Manufacturing Overhead

\$30, 200

\$9, 400

\$21, 850

\$61, 450 * 1. 5

Company's Bid Price

\$92, 175

6. At the end of the year, the company assembled the following actual cost data relating to all jobs worked on during the year:

Department

Cutting

Machining

Assembly

Total Plant

Direct materials

\$760, 000

\$90, 000

\$410, 000

\$1, 260, 000

Direct labor

\$320, 000

\$210, 000

\$340, 000

\$870, 000

Manufacturing overhead

\$560, 000

\$830, 000

\$92, 000

\$1, 482, 000

Compute the underapplied or overapplied for the year (a) assuming that a plantwide overhead rate is used, and (b) assuming that departmental overhead rates are used.

7. Write a short memo Sandy Kovallas recommending a solution to the problem you identified in question 1.

Case #1, Part 2

Cristin Madsen has recently been transferred to the Appliance Division of Solequin Corporation. Shortly after taking over her new position as divisional controller, she was asked to develop the division's predetermined overhead rate for the upcoming year. The accuracy of the rate is important because it is used throughout the year and any overapplied overhead is closed out to Cost of Goods Sold at the end of the year. Solequin Corporation uses direct labor-hours in all of its divisions as the allocation base for manufacturing overhead.

To compute the predetermined overhead rate, Cristin divided her estimate of the total manufacturing overhead for the coming year. She took her computations to the division's general manager for approval but was quite surprised when he suggested a modification in the base. Her conversation with the general manager of the Appliance Division, Lance Jusic, went like this:

Madsen: Here are my calculations for next year's predetermined overhead rate. If you approve, we can enter the rate into the computer on January and be up and running in the job-order costing system right away this year.

Jusic: Thanks for coming up with the calculation so quickly, and they look just fine. There is, however, one slight modification I would like to see. Your estimate of the total direct labor-hours for the year is 110, 000 hours. How about cutting that to about 105, 000 hours?

Madsen: I don't know if I can do that. The production manager says she will need about 110, 000 direct labor-hours during the current year and sales are projected to be higher next year.

Jusic: Cristin, I know all of that. I would still like to reduce the direct labor-hours in the base to something like 105, 000 hours. You probably don't know that I had an agreement with your predecessor as divisional controller to shave 5% or so off the estimated direct labor-hours every year. That way, we kept a reserve that usually results in a big boost to net operating income at the end of the fiscal year in December. We called it our Christmas bonus. Corporate headquarters always seemed as pleased as punch that we could pull off such a miracle at the end of the year. This system has worked well for many years, and I don't want to change it now.

Required:

1. Explain how shaving 5% off the estimated direct labor-hours in the base for the predetermined overhead rate usually results in a big boost in net operating income at the end of the fiscal year. 2. Should Cristin Madsen go along with the general manager's request to reduce the direct labor-hours in the predetermined overhead rate computation to 105, 000 direct labor-hours? Why? Reflect on your own statement of ethics or code. What specifically, from your own code, will you draw on in making this decision?