Rio grande medical center case study

Education

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Case Study# 3 Rio Grande Medical Center-Cost Allocation Concepts 1) Is it fair for the Dialysis Center to suffer (in profitability) from the move even though it had nothing to do with it? I do not think that the Dialysis Center suffering in profitability from the move is fair. Being that the Dialysis Center was moved as a result of the Outpatient Clinics need for extra space, I do think that some of the costs of the new building and the relocation of the Dialysis Center should be paid through the Outpatient Center (a " buy out").

The fact that the indirect costs of the Dialysis Center are going up solely because of the fact that they were forced out to accommodate the Outpatient Center, forcing them into the red, is simply unfair and bad practice. 2) Should the Dialysis Center be charged actual facilities costs for its new location? After all, the move was forced by the Outpatient Clinic, which is being charged for facilities at the lower average allocation rate.

Under the concept of charging for actual facilities costs, department heads may be better off resisting proposed moves to new (and potentially more efficient) facilities because such moves would result in increased facilities allocations. Without the expansion, the Dialysis Center was paying $300, 000 in facilities costs ($15 per square foot x 20, 000 square feet). With the expansion, the Dialysis Center is paying $400, 000 in facilities costs, $100, 000 more solely because of the move forced upon them due to the Outpatient Centers need for more space.

I believethat the Dialysis Center should pay the same amount in facilities costs considering that they would have the same amount of square footage as they did before the move. All or at least a portion of the additional $100, 000 in facilities costs should be absorbed by the Outpatient Center, not only

did they force the Dialysis Center out, but they also have an expected 25 percent increase in volume while the Dialysis Center is expected to have no increases at all. 3)

Even if the true cost concept were applied to the Dialysis Center, is the 400, 000 annual allocation amount correct? After all, the building has a useful life that is probably significantly longer than 20 years – the life of the loan used to determine the allocation amount. If the true cost concept is applied, what would be the allocation in the 21st year, after the mortgage had been paid off? 4) The revenue that the Dialysis Center " receives" from patient use of the pharmacy appears to be passed on directly to the pharmacy.

That is, the Dialysis Center books $800, 000 in annual revenue but then is charged $800, 000 for the drugs used. Should this " revenue" be counted when general overhead allocations are made? To make this point, John discovered that the pharmacy supplies used for dialysis actually cost the pharmacy $400, 000, so the pharmacy makes a profit of $400, 000 on drugs that are actually " sold" by the Dialysis Center.