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Colin Drury, Management and Cost Accounting - Dumbellow Ltd Dumbellow Ltd Stan Brignall, Aston Business School The Board of Dumbellow Ltd are meeting on the 23rd January to discuss the draft budget for 2000/1, some two months before the start of that year. The company produces three industrial valves which are incorporated into equipment used in the Oil and Gas industry. The draft income statement is as follows: Product X ? k Sales 100k units at ? 15 80k units at ? 25 120k units at ? 0 Materials Labour Overheads Profit/(Loss) 300 700 225 1225 275 400 800 360 1560 440 1500 2000 1200 480 750 330 1560 (360) 4700 1180 2250 915 4345 355 Product Y ? k Product Z ? k Total ? k The Board are unhappy with this planned outcome in two respects: they had hoped for a total profit of at least ? 400k to meet their required 20% return on capital; and they are unhappy about the further deterioration of Product Z, their oldest product, which on current plans would move from being marginally unprofitable this year to highly unprofitable next. Responses to the situation varied.

Paul Burns, the recently-appointed Financial Controller who compiled the budget, thought that the best response would be to stop making product Z. He argued, 'Knowing the unsatisfactory results this budget contains, I took the liberty of doing some rough calculations before coming to this meeting. If we drop Z we can eliminate the fixed labour costs associated with it of ? 90k and sell the machinery specifically associated with it which, being old, is now fully-written off but would probably fetch ? 5K. There will, however, be redundancy costs which I estimate at ? 0k. ' Arthur Mitchell, the Production manager and oldest member of the management team, was outraged. He said, 'That's typical of you accountants. We've been making Z since the firm

started twenty years ago and it still has steady sales. Also, some of the blokes making it have been with the company a long time. You knew what the situation looked like: why didn't you tell me before the meeting? Can't I have a bit of time to look for ways of saving costs on the production line? ' Paul Burns sneeringly replied, 'If you can do that, why haven't you done so before?

I offered to help you look at your costs when I arrived last year, but when I proposed investigating the merits of Activity Based Costing you said you had no time to waste on such nonsense. You can't blame me for not consulting you! ' At this point Bob Berry, the Marketing manager, roused himself and smoothly announced, 'There's no need for you two to bicker like this. I think the sales position would encourage us to lower the price of Z by ? 1 per unit which I think would raise demand by 25%. If Arthur can save that ? per unit in variable production costs somehow, why don't we try that combination? ' Ben Kates, the Managing Director, now intervened. 'I'd like to compare the effects of adopting Bob's suggestion versus Paul's. Arthur, would you also like to take a little time to think how best you might re-organise production so as to improve matters, and pass your thoughts to Paul for him to turn into financial figures. And, Paul, I'd like you to try seeing what a simple 10% increase in sales and activity across the board would do, holding prices and everything else constant.

After all, we have got a fair bit of spare capacity, haven't we Arthur? ' The meeting broke-up at this point, having agreed to proceed on the lines set out by Ben Kates. Colin Drury, Management and Cost Accounting - Dumbellow Ltd i linu 4 ? a The next day Arthur Mitchell phoned Paul's office and, having

ascertained that he was in, went over to kemur 75 see him. 'I've done some thinking, and I think we could cut labour supervision on Product Z which per unit a a? would reduce labour fixed costs by ? 5k but increase the variable overhead element by 10%. We vera 0, 75 could also substitute a cheaper component for Z which would save 75 per unit. Can you please try that and see what it looks like? ' Paul replied, 'If I must, but I don't suppose it will do any good. ' Before starting his work on revising the budget, Paul reviewed in his mind the following information used in compiling the original budget: 1) all material costs are fully variable 2) the fixed element of labour cost for X, Y and Z is ? 00k, ? 160k and ? 90k respectively 3) the overheads are mixed costs. The fixed element has been absorbed at the rate of ? 5 per machine hour irrespective of the machines used. The machine time per unit of each of the products is: X Y Z 15 minutes 30 minutes 15 minutes A week later the Dumbellow Board reconvened to look at the revised budget calculations. Required Write a report to Dumbellow's Board setting out appropriate calculations and making your recommendation as to which course to follow.

Your report should cover the following: a) a discussion of the benefits of marginal costing statements for decision-making when compared with full cost statements. b) a statement of total contribution and profit for the original budget and each of the four proposals. c) state any reservations you have about your analyses and recommendation. Are there any other non-financial aspects of the case, such as organizational behaviour issues, that seem worthy of consideration or comment?