

# Office dakota products case analysis

Business



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Office Dakota Products Case Analysis Course: BUSA 5061 Managerial Accounting Students Name: Teresa Willette Professors Name: Dr. Conner/Dr. Pollard Date 3/20/2011 Executive Summary The following analysis is written for Dakota Office Products to evaluate current business operations and recommend future actions necessary to ensure company success. In the analysis of the company we will identify inefficient business practices that have led to the companies first profit loss in its history.

We will evaluate the companys current pricing structure, ordering methods, shipping and delivery process, and deficiencies in cash flows. For Dakota Office Products (DOP), its existing costing system was inadequate because it is incapable of accounting for even all of the known costs such as the desktop delivery service as well as hidden costs such as the ten percent DOP paid to maintain its working capital line of credit for accounts receivable.

Using the Activity Based Costing(ABC) methodology can be utilized to also improve processes and identify opportunities to improve business effectiveness and efficiency by determining the true or real costs of a given product or service. ABC principles are used to focus management's attention on the total cost to produce a product or service, and as a basis for full cost recovery of a production or service process. Background Information The company under the study, Dakota Office Products, is an established and reputed player under this segment.

They were regional distributors for office supplies and the major clientele served by the company included institutional and commercial clients. It dealt with all kind of office supplies starting from all kinds of writing equipment to

papers and other office supplies. The company has been able to carve a good name for itself in the industry. The company had also arranged for several distribution centers where the shipments were required to be unloaded and packed into cartons meant to be delivered to the respective customers.

In order to increase the utility for its customers, the company had introduced the desk top option for its valued customers. Under this option, the company will use its own fleet to directly deliver the goods at the customers premises. The company charged a small additional amount of upto 2% of the marked price for this additional value added service. This decision was made keeping in mind that such a decision could boost the margins of the company. The company had the policy of marking the sales price by 15% over and above the purchase price. This policy was framed to ensure that the overheads and transportation cost of the materials could be made up from the mark up. The company would then add another mark up to ensure coverage of general expenses and contribution of the company. The mark up decision was taken at the beginning of the year based on the projected cost of the different products of the company. Key Issues The management is faced with major pricing and costing issue for its products. The company has been using the traditional costing method to compute the cost of the product provided to the clients.

The company then adds a mark up as per its policy to come up at the selling price of the product. As a result of not following the Activity Based Costing, the company has not been able to cost the products realistically. This has lead to mispricing of the products and resultant overall loss to the company.

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The fact that an increase in sales has not lead to an increased profits, instead, it has resulted in increased losses has exposed the limitations of the cost accounting system of the company. The company has not been able to increase its profits.

This has led the management to believe that the existing cost accounting system has some serious flaws which needs to be rectified on an immediate basis so as to avoid making bad decision leading to losses to the company. The company should now be contemplating the implementation of Activity based costing system so as to ensure proper recording of information which will lead to optimum decision making for the company as a whole thus contributing to the growth of the company through increased profitability. The key issue presented in front of the management is the possible steps to be taken by the management in order to avoid such losses.

Critical Thought The issue addressed by the accounting system of Dakota office products invites our attention to the premise of Activity Based costing methodology. We are certain about the fact that the accounting and reporting system at Dakota Office Product is inappropriate and is leading to the company making wrong decision ultimately leading to losses. This was apparent from the record where the company was able to increase its sales without a corresponding increase in the profits for that particular year.

Activity based costing system is an approach which seeks to allocate the overhead cost to the products on a scientific and realistic basis. The existing system of allocating cost at Dakota Office products were inadequate in so much so that it was following an unreasonable basis for allocating the cost,

which were known and visible, such as the desktop delivery cost. The existing system was suffering from oversight of some of the expenses. ABC costing system seeks to overcome the problem of oversight and make a more reasonable allocation of the costs.

The distinctive feature of this method is the fact that the method can provide useful insights to the management as to the activities which are leading to the cost by identifying the cost drivers, rates and the number of activity undertaken. This can also help the management redesign the operational system such that the costs associated with the products are reduced. We must also note that the traditional method of costing adapted by Dakota Office Products are typically designed for companies who are dealing with only a single product, or homogeneous products.

However Dakota Office Products have come to a stage that they are dealing in multiple products such as writing instruments to copier to pages, thus it makes the traditional costing method even more impractical to be followed by the company. This company was dealing in numerous products and was also making strides in adapting varied operational methodologies such as the desktop delivery or the sales through e commerce internet sites. The operations of the company are such that it would be apt for the company to establish a cost driver rates and apply those rates in the products of the company.

The cost driver rates could also be used by the company while applying the cost overheads to some other products that the company may be planning in the future. The existing system of the company involves use of many

activities and the company has been able to regularize the operations of the company and is clear about the operational goal that need to be fulfilled by the company. The company is dealing in an industry where the products are quite heterogeneous in nature and once the products are purchased there is very little scope of application of direct materials or labor.

The major cost that is expected to be incurred is the overhead costs which are factual dependent upon the number of activities undertaken to accomplish the task. The cost drivers need to be ascertained before the application of the cost drivers to the number of activities attributable to the product as regards the particular activity. Alternate Solution A noteworthy fact is that the company has posted increased losses in spite of an increase in overall sales of the company. The objective of the exercise is to let the management be aware of the reasons as to why the company has posted losses even after an increase in the sales. Moreover, the management needs to be shown the way by which the company could remedial action so that the managements direction is towards the right direction. The alternate solution available to the company could be enlisted as follows Increase in selling price of the products Review the accounting procedures and implement the change required in accounting procedures Discontinue the product which reports a loss We will make a brief study of the above alternatives before forming an opinion on any of the alternatives.

As the company is operating in a competitive market, so an increase in selling price of the products is expected to have far reaching repercussions in the sense that the company could go on to lose clients and contracts which could lead to even lower sales and higher losses. Moreover, the <https://assignbuster.com/office-dakota-products-case-analysis/>

existing accounting procedure is inappropriate to produce the actual cost of the product. The computation of actual cost of the product is important in the backdrop of the company policy to add a mark up on the cost price of the goods.

If the accounting system is inappropriate to calculate the cost of the cost, then it would be inappropriate to add a mark up on the goods based on the cost as produced by the existing accounting procedure. A review of the accounting procedure is duly called for as the existing accounting procedure is not appropriate. The accounting procedure is not apt for a company having multiple products and multiple processes, and very little expenses on the direct materials and labor. Application and implementation of the ABC system will be able to contribute to the accounting procedure adapted by the company.

A product which is not able to contribute to the overall profits of the company could be considered to be discontinued. However, the decision of the product to be discontinued lies with the management and the accounting system. As mentioned earlier, the accounting system is not fit, so the company should first implement an ABC costing system in order to make proper decision regarding the costing and pricing of various products as well as the costing of servicing various clients.

Implementation Measures and Follow up Dakota was following the traditional method of allocating overheads across the product lines. The overheads were not allocated to the products based on the activity undertaken for the manufacture of the product. This led to mispricing of the product and also

led to difficulty in taking optimum decision for the company as a whole. The company had incurred losses in spite of an increase in sales, because the company was selling a product at a loss (which was not detected by the traditional costing system).

We need to identify the activities on which the cost is dependant, in order to calculate the cost driver rate. The following are the activities identified

Processing of Cartons (Activity 1) Service Involving Desktop Delivery (Activity

2) Order Handling (Activity 3) Data Processing and Entry (Activity 4) Activity

1 Amount of Expenses = Warehouse Personnel Expense (90%) + Items

Purchased =  $90\% \times 2400000 + 35000000 = 2160000 + 35000000 =$

37160000. Activity Driver (Processing of Carton) = 80000 Cost Driver Rate

for Activity 1 =  $37160000 / 80000 = \$ 464.5$  per carton.

Activity 2 Amount of Expenses = Warehouse Personnel Expense (10%) +

Delivery Truck Expense =  $10\% \times 2400000 + 200000 = 240000 + 200000 =$

440000 Activity Driver (Desktop Delivery) = 2000 Cost Driver Rate for

Activity 2 =  $440000 / 2000 = \$ 220$  per carton. Activity 3 Amount of

Expenses = Warehouse Expense + Freight =  $2000000 + 450000 = 2450000$

Activity Driver (Orders) =  $16000 + 8000 = 24000$  Cost Driver Rate for Activity

3 =  $2450000 / 24000 = \$ 102.083$  per order. Activity 4 Amount of Expenses

= Order Entry Expenses = 800000 Activity Driver (Orders Line) = 150000

Cost Driver Rate for Activity 4 =  $800000 / 150000 = \$ 5.33$  per line. The

implementation involves computing the profitability of the two clients A

Sales Cost Gross Margin No of Cartons Ordered 464.5 92900 9290 0 B 1040

103000 00 8500 85000 0 1900 18000 0 Desktop Deliveries 220 Order

Handling 102.083 1224.996 Data Entry 5.33 Total Cost 319.8 94444.8

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959. 4 1095 67. 7 5567. 7 1020 8. 3 0 5500 Contribution 8555. 204 The following are the main causes of difference in profitability between the two customers Customer B has a desktop deliver of 25 whereas customer A has none. The number of data entry for customer B is 180 whereas it is about 60 for customer A.

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