AC – Eksamen Disposition

Q1)) Discuss pros and cons of different types of cost-based transfer prices.

1. *Full-cost transfer prices*

- *Company use: If no external market*
- *Company use: If selling specialized items*
- *Then FC could be the best alternative*

Pro's

- Easy to **implement**
- Easy to **understand**
- Seen as **objective**
- Low **cost of implementation**
- Used for **external reporting**

Con's

- Overstates opportunity cost **of producing 1 more unit internally** (under excess capacity)
- Moral hazard. Selling can transfer inefficiencies To buying

2. *Variable cost transfer prices*

- *Company use: If no opportunity cost*
- *Company use: If no external market or specialized items*
- *Company HAS: Excess capacity and FC overstates opportunity cost*
- *Then VC could be the best alternative*

Pro's – why use VC?

- If no **external market** and **excess capacity**
- Easy to **understand** and calculate
- If there's excess **capacity**

Con's

- **Manufacturing with variable** cost, doesn't always **cover the fixed** costs.

- **Product Proliferation.** VC varies with output of Q but no capacity use (**Solution: ABC and CVP in plastic factory**)
- Moral hazard and adverse selection: **Managers misclassifying e.g electricity FC as VC (Solution: Double-monitoring or open-book accounting)**
- **Incentive to lower cost as cost-center. The Ratched effect** between a cost center and profit center

5. Perspectivation:

ARTICLE: Fisher and General Motors /// The Plastic Factory

Q5)) Discuss pros and cons of using market-based transfer prices.

1. *Market-based transfer prices*

Pro's

- The **economic textbook** example – closets to **opportunity cost (supply=demand)**
- Good to analyze if company should produce **internal or outsource capacity**
- Less **subject to manipulation**
- With **no idle capacity**, it's the closest to the opportunity cost

Con's

- If no external market - **Specialty items** and **benchmarks.**
- **Adverse selection** and **moral hazard** in managers choosing **benchmarks**
- Difficult to calculate **internal synergies (bear and marmons)**
- **Competition** between divisions doesn't equal **cooperation**

2. *Why do we use other transfer prices?*

- If small market: **Negotiated transfer** prices to **boost cooperation and decision making** and catches **internal synergies) (conflicts and bad equilibrium)**
- Full cost of external report and simplicity (**Overstates OC under excess cap and incentives to missclassify)**
- VC when there's excess capacity (**Profit proliferation and misclassifying)**

- 12 months to **spend surplus funds on needs** for the year
- After 28,5 months unspent money are **not allowed** to be transferred

The conditions for agents to move funds over

- **Why is there surplus** (still adverse selection to some extent)
- **For which purpose** will the surplus be spent (still adverse selection to some extent)
- **Only spend on non-reoccuring** items (moral hazard)

4. Oklahoma benefits

- **Reduced the wasteful end-of-year spending**

- Increased flexibility of spending

- Encouraged savings

- Improve **planning**

- Decreased **rachet effect**

- Decrease paperwork/monitoring from toplevel managers

5. When is carry-over less beneficial

- Departments with **tight budgets** where simply have **no funds to carry-over**

- Departments with **strict line-items rules,** meaning they **can‘t really spend funds elsewhere**

- Departments with **2 year budgets** = 40,5 months of carry over = not permitted

- Departments with funds that can‘t be **withdrawn** after **any period**