



The Markley Division

MBA 628: Managerial Accounting Instructor: Dr. Juan J. Segovia

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THE NUMBER CRUNCHERS

Simon Foucher – *Project Manager*

 Geneviève Lavigueur – *Consultant*

Leo Pérez Saba – *Final Draft Writer*

Mohamed Shadi – *Consultant*

Kenny Somerville – *Exhibit Manager*

**Problem Definition**

The Markley Division of Rosette Industries has an ineffective budgeting system that prevents them from fully understanding the causes of manufacturing variances. As a consequence, the division cannot apply timely corrective measures in order to improve the division’s operating income.

**Quantitative Analysis**

[(Examines the causes of the $32,600 unfavourable income variance (Q1)]

* Exhibit 1 shows the flexible budget data broken down by products and the different cost categories. The contribution margin per unit of metal is twice that of plastic.
* Exhibit 2 provides a Level 2 analysis by breaking down the static budget variance into flexible budget and sales volume variances for all line items in the division’s first quarter results. It is evident that most of the variance comes from flexible budget variance ($41,100U) and not sales volume variance ($8,500F).
* Exhibit 3 provides a Level 3 analysis by breaking down the variable manufacturing cost variances into price variances and efficiency variances for both plastic and metal chairs. Except for 39,000U due to the higher price paid for plastic materials, most of the unfavourable variances come from efficiency variances. In addition, the plastic chair efficiency variance is significantly larger ($7,400U) than the metal chair efficiency variance ($2,600U). The spending variances are almost negligible (a total 600U for both metal and plastic chairs).
* Exhibit 4 shows fluctuations that occurred in finished goods and raw materials inventory ($64,600) as a result of purchasing more materials that were required for manufacturing. For metal, the division manufactured more units than it sold ($25,000 in inventory increase), and for plastic it sold more than it produced for the period ($40,000 in inventory reduction). The net change in inventory value was $15,000 – these changes will not affect the income statement.

**Qualitative Analysis**

* The major causes of Markley’s unfavourable profit performance include the purchase price and usage of direct materials, and in general terms the efficiency of the plastic chair manufacturing line as shown in Exhibit 3 (Q2a).
* Because the status report published two months into the first quarter did not contain enough details regarding variances or actual costs, management was not able to implement corrective actions (Q2b).
* If the division would have more closely monitored the actual raw material prices, they could have modified the sales prices in order to maximize their profits (for plastic chairs) (it seems like they increased the price of the plastic chairs to $10.50 = 630K/60K) and market share (for metal chairs).
* Sales were higher than budgeted for plastic, which has a lower contribution margin (14% sales), and lower than budget for the Metal chairs, which carry a higher contribution margin (27%). Therefore the company should look into changing prices and/or commission plans.
* A significant portion of the static variance is derived from standard variable manufacturing costs, as opposed to actual costs. We can therefore assign the variance to the purchasing department, but we cannot necessarily blame the purchasing manager since the raw material variance ($39,000) could be a result of higher market prices, higher quality raw materials or poor negotiation skills.
* The company should try to reduce waste in manufacturing, especially for the metal line where waste rates are higher. This could be done by implementing Six Sigma or Lean Manufacturing principals, and enforced by integrating a waste reduction target in manufacturing management’s bonus pay.

**Recommendation**

## We recommend that Markley’s management adopt the following steps to improve the division’s operating income:

## Implement a flexible budget plan and compare to actual results monthly in order to facilitate implementation of corrective actions.

## Increase the sales prices of plastic chairs by $1. At the same time, decrease the price of metal chairs by $1.

## Adjust the budgeted cost per unit in order to reflect the price increase in raw materials.

## Exhibits