

Hayek Global College

MBA Class

Accounting and Control Q3-21

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CASE STUDY 2 – THE PRESTIGE TELEPHONE CO.

In this it is a great illustration, we can understand how much important is to have a really good (and even more important trustable), accountant, and how this negligence made a huge company just ruin, losing their reputation.

The case is about a Prestige Telephone, a company that aiming grow your services and revenue, adopted a computer data service subsidiary to work in data processing for a telephone company and to sell computer service to other companies.

The main problem behind Prestige Telephone was, eventually, they realized later they made a terrific mistake in these investments' idea, because the demands, costs and revenues just were not sustainable, what brought a lot of losses to the company

To better understand the case, some questions need to be answered. Some hints were given by the professor as we can see in the following:

1. Power has two components: fixed cost and variable cost.
2. Operations (wages and salaries) have two components: fixed and variable.
3. Disregard material and corporate services from your costs analysis and classification.
4. Assume that sales promotion is \$8,000 and it is a fixed cost.

Fixed Cost / Unit Contribution Margin = BEP in Units

Fixed Cost/ Contribution Margin Percentage = BEP in \$

1. Assuming the company (Prestige Telephone Company) demand for service will average 205 hours per month, what level of commercial sales of computer use would be necessary to break even each month?

As we learned in the writings of *Accounting Principles*, the break-even point is achieved when total revenues become the same of total costs amount (both fixed and variable). So, aiming the result that shows us the level of commercial sales of computer use that would be necessary to break even, we need to calculate the variable costs and the fixed costs, as they are needed for the equation related to the CVP analysis.

So, using this metrics, we have the following calculation:

No of revenue hours	584	512		
Power	1,633	1,592		
	HIGH	LOW		
	levels of activity			
	Activity level			
	High	Low		
Total power cost	1,633	1,592		
<i>Less</i>			0.57	variable cost per unit
Variable costs	332.88	291.84		
Fixed costs	1,300	1,300		
	January	February		
No of revenue hours	584	512	72	
Operations	29,496	29,184		
	high	low		
			4.33	variable cost per unit
	Activity level			
	High	Low		
Total operations cost	29,496	29,184	312	
<i>Less</i>				
Variable costs	2528.72	2216.96		
Fixed costs	26,967	26,967		

Explaining, we use a and high-low method, the same that was used in the terms of p. 966 of this same *Account principles* book explanation, as we can see in the next:

“For purposes of cost-volume-profit analysis, mixed costs must be classified into their fixed and variable elements. How does management make the classification? One possibility is to determine the variable and fixed components each time a mixed cost is incurred. But because of time and cost constraints, this approach is rarely followed. Instead, the usual approach is to Mixed Costs Analysis 967 collect data on the behavior of the mixed costs at various levels of activity.

Analysts then identify the fixed-and variable-cost components. Companies use various types of analysis. One type of analysis, called the high-low method, is discussed next”

With this, we can conclude that the result is achieved by subtracting the highest and the lowest from the initial and final month here given, and with this result we multiply this index for the number of each revenue hours, and as we can ensure, the numbers are proportionally the same on all of them.

2. Estimate the effect on income (for the month of March) of each of the options Rowe has suggested if Bradley estimates as follows:

a) increasing the price to commercial customers to \$1000 per hour would reduce demand by 30 percent

Revenues	Currently	Hypothesis “a”
Intercompany sales	\$89,200	\$89,200
Commercial sales		
Computer use	110,400	107640
Other	12,685	12,685
Total revenue	\$212,285	\$209,525
Expenses		
Space costs		
Rent	\$8,000	\$8,000
Custodial services	1,240	1,240
	\$9,240	\$9,240
Equipment costs		
Computer leases	95,000	95,000
Maintenance	5,400	5,400
<i>Depreciation:</i>		
Computer equipment	25,500	25,500

Office equipment and fixtures	680	680
Power - total	1,803	1,953
Power - fixed cost	1,300	1,300
Power - variable cost	\$503	653.02
	\$128,383	\$128,533
Wages and salaries		
Operations - total	30,264	50,834
Operations - fixed cost	26,967	26,967
Operations - variable	3,297	23,867
Systems development and maintenance	12,000	12,000
Administration	9,000	9,000
Sales	11,200	11,200
	\$62,464	\$83,034
Materials	10,317	10,317
Sales promotions - fixed costs	8,000	8,000
Corporate services	15,236	15,236
	\$33,553	\$33,553
Total expenses	\$233,640	\$254,360
Net income (loss)	(\$21,355)	(\$44,835)

b) reducing the price to commercial customers to \$600 per hour would increase demand by 30 percent

Revenues	Currently	Hypothesis "b"
Intercompany sales	\$89,200	\$89,200
Commercial sales		
Computer use	110,400	107640
Other	12,685	12,685
Total revenue	\$212,285	\$209,525
Expenses		
Space costs		
Rent	\$8,000	\$8,000
Custodial services	1,240	1,240
	\$9,240	\$9,240
Equipment costs		
Computer leases	95,000	95,000
Maintenance	5,400	5,400
<i>Depreciation:</i>		

Computer equipment	25,500	25,500
Office equipment and fixtures	680	680
Power - total	1,803	1,953
Power - fixed cost	1,300	1,300
Power - variable cost	\$503	653.02
	\$128,383	\$128,533
Wages and salaries		
Operations - total	30,264	50,834
Operations - fixed cost	26,967	26,967
Operations - variable	3,297	23,867
Systems development and maintenance	12,000	12,000
Administration	9,000	9,000
Sales	11,200	11,200
	\$62,464	\$83,034
Materials	10,317	10,317
Sales promotions - fixed costs	8,000	8,000
Corporate services	15,236	15,236
	\$33,553	\$33,553
Total expenses	\$233,640	\$254,360
Net income (loss)	(\$21,355)	(\$44,835)

c) Increased promotion would increase sales by up to 30 percent. Bradley is unsure how much promotion this would take.

Revenues	Currently	Hypothesis "c"
Intercompany sales	\$89,200	\$89,200
Commercial sales		
Computer use	110,400	107640
Other	12,685	12,685
Total revenue	\$212,285	\$209,525
Expenses		
Space costs		
Rent	\$8,000	\$8,000
Custodial services	1,240	1,240
	\$9,240	\$9,240
Equipment costs		
Computer leases	95,000	95,000
Maintenance	5,400	5,400
<i>Depreciation:</i>		

Computer equipment	25,500	25,500
Office equipment and fixtures	680	680
Power - total	1,803	1,953
Power - fixed cost	1,300	1,300
Power - variable cost	\$503	653.02
	\$128,383	\$128,533
Wages and salaries		
Operations - total	30,264	50,834
Operations - fixed cost	26,967	26,967
Operations - variable	3,297	23,867
Systems development and maintenance	12,000	12,000
Administration	9,000	9,000
Sales	11,200	11,200
	\$62,464	\$83,034
Materials	10,317	10,317
Sales promotions - fixed costs	8,000	8,000
Corporate services	15,236	15,236
	\$33,553	\$33,553
Total expenses	\$233,640	\$254,360
Net income (loss)	(\$21,355)	(\$44,835)

d) d. Reducing operations to 16 hours on weekdays and eight hours on Saturdays would result in a loss of 20 percent of commercial revenue hours

Revenues	Currently	Hypothesis "d"
Intercompany sales	\$89,200	\$89,200
Commercial sales		
Computer use	110,400	88320
Other	12,685	12,685
Total revenue	\$212,285	\$190,205
Expenses		
Space costs		
Rent	\$8,000	\$8,000
Custodial services	1,240	1,240
	\$9,240	\$9,240
Equipment costs		
Computer leases	95,000	95,000
Maintenance	5,400	5,400

<i>Depreciation:</i>		
Computer equipment	25,500	25,500
Office equipment and fixtures	680	680
Power - total	1,803	1,702
Power - fixed cost	1,300	1,300
Power - variable cost	\$503	401.86
	\$128,383	\$128,282
Wages and salaries		
Operations - total	30,264	41,655
Operations - fixed cost	26,967	26,967
Operations - variable	3,297	14,688
Systems development and maintenance	12,000	12,000
Administration	9,000	9,000
Sales	11,200	11,200
	\$62,464	\$73,855
Materials	10,317	10,317
Sales promotions - fixed costs	8,000	8,000
Corporate services	15,236	15,236
	\$33,553	\$33,553
Total expenses	\$233,640	\$244,929
Net income (loss)	(\$21,355)	(\$54,724)

3. Can you suggest changes in the accounting and reporting system now used for operations of Prestige Data Services which would result in more useful information for Rowe and Bradley?

As we studied, the way the company was calculating their accounting was just not the recommended, and it was creating a huge confusion in their decision, so, what I would humbly suggest to them is just suggest they start to use only the consolidated results to both main and subsidiary company, analyzing the fixed costs, and not only the gross numbers, but the benefits to the both companies in general, otherwise, they will look only to the (non) profits in short time, and will lose a great opportunity of creating something really relevant, and even profitable in future.