

Hayek Global College

Accounting and Control

2nd Case – Prestige Telephone Company

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Assignment Questions

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?

Cost volume profit analysis requires us to differentiate between fixed and variable cost.

Variable Cost:

Total Power cost: $\$1,623 + \$1,592 + \$1,803 = \$5,028$

Total Operational expenses: $\$29,496 + \$29,184 + \$30,264 = \$88,944$

Total Computer Hours Used: $361 + 348 + 401 = 1,110$

Total variable Cost per hour:

$\$5,028 / 1,110 = \4.53

$\$88,944 / 1,110 = \80.13

Contribution margin = Sales - Variable Cost = $\$800 - (\$4.53 + \$80.13) = \715.34

Prestige telephone company has the agreement to cover \$82,000 of Prestige data Services

Break even analysis

Total Fixed Costs - (Cost Covering by Prestige Telephone Company - Average monthly hours x Variable cost per unit) / Contribution Margin

Fixed cost = $(\$9,240 + \$95,000 + \$5,400 + \$25,500 + \$680 + \$12,000 + \$9,000 + \$11,200 + \$7,677 + \$15,340) = \mathbf{\$191,037}$

$191,037 - (82,000 - 205 * 84.66) / 715.34 = \mathbf{176.7 \text{ hours}}$

$176.7 \text{ h} \times \$800 = \mathbf{\$141,360}$ monthly revenue

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

1. Increasing the price to commercial customers to \$1,000 per hour would reduce demand by 30%.

In March 1997 commercial demand was 138 hours, so $138 \times 0.70 = 96.6$ hours

Demand x contribution per hour = $\$1000 - (\$84.66 \times 96.6h) = 915.34 \times 96.6h =$
\$88,421.85

Compare to Present: $138 h \times (\$800 - \$84.66) =$ **\$98,716.92**

It is almost 10k higher, so income will be higher if we keep the price at \$800/hour.

2. Reducing the price to commercial customers to \$600 per hour would increase demand by 30%.

$138h \times 1.30 = 174.9 h$

$174.9 h \times (\$600 - \$84.66) =$ **\$92,451.70**

Present contribution = **\$98,716.92**

3. Increased promotion would increase sales by up to 30%. Bradley is unsure how much promotion this would take. (How much could be spent and still leave Prestige Data Services with no reported loss each month if commercial hours were increased 30%?)

$179h \times (\$800 - \$84.66) =$ \$128,045.86

$\$128,045.86 - \$98,716 =$ **\$29,329** – this amount could be spent without reducing income

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

$138h \times 0.80 = 110$ hours

$110 h \times (\$800 - \$84.66) =$ \$78,687

$\$98,716 - \$78,687 =$ **\$20,029**

Wages, material and suppliers will be affected by this reduction of the revenue, other expenses probably not

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?

Combine the financial statements of both companies, as this way it will be visible the true contribution that the Prestige Data Services is providing to the Prestige Telephone Company. Variable costs is what the managers should look into, not all the costs.