

Solution to Question a)i.

When transfer price is based on 200% of unit variable cost

	Fishing £	Processing £	Marketing £
Variable cost	0.20	0.80	0.30
Transfer price	<u>-</u>	<u>0.40</u>	<u>4.80*</u>
	0.20	1.20	5.10
Fixed cost	<u>0.40</u>	<u>0.60</u>	<u>0.70</u>
Full cost	0.60	1.80	5.80
Profit	<u>(0.20)</u>	<u>0.60</u>	<u>4.40</u>
Selling/Transfer price	<u>0.40</u>	<u>2.40</u>	<u>10.20</u>

2kg of input needed from Processing to make a 2kg packet of fish => TP is 2£2.40

Solution to Question a)ii.

When transfer price is based on 150% of unit total cost

	Fishing £	Processing £	Marketing £
Variable cost	0.20	0.80	0.30
Transfer price	<u>-</u>	<u>0.90</u>	<u>6.90*</u>
	0.20	1.70	7.20
Fixed cost	<u>0.40</u>	<u>0.60</u>	<u>0.70</u>
Full cost	0.60	2.30	7.90
Profit	<u>0.30</u>	<u>1.15</u>	<u>3.95</u>
Selling/Transfer price	<u>0.90</u>	<u>3.45</u>	<u>11.85</u>

2kg of input needed from Processing to make a 2kg packet of fish => TP is 2£3.45

Solution to Question a)iii.

When transfer price is based on the unit market price

	Fishing £	Processing £	Marketing £
Variable cost	0.20	0.80	0.30
Transfer price	<u>-</u>	<u>1.00</u>	<u>10.00</u>
	0.20	1.80	10.30
Fixed cost	<u>0.40</u>	<u>0.60</u>	<u>0.70</u>
Full cost	0.60	2.40	11.00
Profit	<u>0.40</u>	<u>2.60</u>	<u>1.00</u>
Selling/Transfer price	<u>1.00</u>	<u>5.00</u>	<u>12.00</u>

Solution to Question b)

Goal congruence problems that may arise if the transfer price is fixed at 150% of full cost:

1. The divisional heads may decide to report an inflated unit cost in order to boost profit margins
2. The fishing division may decide against transferring its own outputs to the processing division, but rather sell outside the group at the market price of £1.00 per kilo, thereby earning extra 10p per kilo in the process.
3. The processing division may also decide against transferring its own outputs to the marketing division, but rather sell to others outside of the group, thereby earning extra £1.55 (£5-£3.45) per kilo.